

# 3

## Incomes Which Do Not Form Part of Total Income

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### Learning Objectives

After studying this chapter, you would be able to understand –

- ◆ which are the income not forming part of total income
- ◆ the extent to which such income are excluded from total income
- ◆ the conditions to be satisfied for availing exemption
- ◆ the conditions to be satisfied by wholly charitable or religious trusts for claiming exemption
- ◆ the cases where anonymous donations are chargeable to tax
- ◆ the categories of income derived by a political party which are exempt from tax
- ◆ the conditions to be fulfilled by the political party to claim such exemption

In this chapter, we are going to study section 10 which enumerates the various categories of income that are exempt from tax. Thereafter, we shall consider section 11, which provides exemption in respect of income derived from property held under trust wholly for charitable or religious purposes. Section 13A exempts certain categories of income derived by a political party and section 13B exempts voluntary contributions received by electoral trusts.

### 1. Incomes not included in Total Income [Section 10]

The various items of income referred to in the different clauses of section 10 are excluded from the total income of an assessee. These incomes are known as exempted incomes. Consequently, such income shall not enter into the computation of taxable income or the rate of tax.

**Restrictions on allowability of expenditure [Section 14A]** – (i) As per section 14A, expenditure incurred in relation to any exempt income is not allowed as a deduction while computing income under any of the five heads of income [Sub-section (1)].

However, the Assessing Officer is not empowered to reassess under section 147 or to pass an order increasing the liability of the assessee by way of enhancing the assessment or reducing a refund already made or otherwise increase the liability of the assessee under section 154, for any assessment year beginning on or before 1.4.2001 i.e. for any assessment year prior to A.Y. 2002-03 [Proviso to sub-section (1)].

The Assessing Officer is empowered to determine the amount of expenditure incurred in relation to such income which does not form part of total income in accordance with such method as may be prescribed [Sub-section (2)].

The method for determining expenditure in relation to exempt income is to be prescribed by the CBDT for the purpose of disallowance of such expenditure under section 14A. Such method should be adopted by the Assessing Officer if he is not satisfied with the correctness of the claim of the assessee, having regard to the accounts of the assessee.

Further, the Assessing Officer is empowered to adopt such method, where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of total income [Sub-section (3)].

Rule 8D lays down the method for determining the amount of expenditure in relation to income not includible in total income.

If the Assessing Officer, having regard to the accounts of the assessee of a previous year, is not satisfied with –

- (a) the correctness of the claim of expenditure by the assessee; or
- (b) the claim made by the assessee that no expenditure has been incurred in relation to exempt income for such previous year,

he shall determine the amount of expenditure in relation to such income in the manner provided hereunder –

The expenditure in relation to income not forming part of total income shall be the aggregate of the following:

- (i) the amount of expenditure directly relating to income which does not form part of total income;
- (ii) in a case where the assessee has incurred expenditure by way of interest during the previous year which is not directly attributable to any particular income or receipt, an amount computed in accordance with the following formula, namely :

$$A \times \frac{B}{C}$$

Where,

A = amount of expenditure by way of interest other than the amount of interest included in clause (i) incurred during the previous year;

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B = the average of value of investment, income from which does not or shall not form part of the total income, as appearing in the balance sheet of the assessee, on the first day and the last day of the previous year;

C = the average of total assets as appearing in the balance sheet of the assessee, on the first day and the last day of the previous year;

'Total assets' means total assets as appearing in the balance sheet excluding the increase on account of revaluation of assets but including the decrease on account of revaluation of assets.

(iii) an amount equal to one-half per cent of the average of the value of investment, income from which does not or shall not form part of the total income, as appearing in the balance sheet of the assessee, on the first day and the last day of the previous year.

**Clarification regarding disallowance of expenses under section 14A in cases where corresponding exempt income has not been earned during the financial year [Circular No. 5/2014, dated 11.2.2014]**

*Section 14A provides that no deduction shall be allowed in respect of expenditure incurred relating to income which does not form part of total income. A controversy has arisen as to whether disallowance can be made by invoking section 14A even in those cases where no income has been earned by an assessee, which has been claimed as exempt during the financial year.*

*The CBDT has, through this Circular, clarified that the legislative intent is to allow only that expenditure which is relatable to earning of income. Therefore, it follows that the expenses which are relatable to earning of exempt income have to be considered for disallowance, irrespective of the fact whether such income has been earned during the financial year or not.*

*The above position is clarified by the usage of the term "includible" in the heading to section 14A [Expenditure incurred in relation to income not includible in total income] and Rule 8D [Method for determining amount of expenditure in relation to income not includible in total income], which indicates that it is not necessary that exempt income should necessarily be included in a particular year's income, for triggering disallowance. Also, the terminology used in section 14A is "income under the Act" and not "income of the year", which again indicates that it is not material that the assessee should have earned such income during the financial year under consideration.*

*In effect, section 14A read along with Rule 8D provides for disallowance of expenditure even where the taxpayer has not earned any exempt income in a particular year.*

**Difference between Section 10 and Chapter VI-A deductions** - Certain other incomes are also wholly or partly rendered tax-free by being allowed as deductions in computation of total income under Chapter VI-A. Students should note a very important difference between exemptions under section 10 and the deductions under Chapter VI-A. While the incomes

which are exempt under section 10 will not be included for computing total income, incomes from which deductions are allowable under Chapter VI-A will first be included in the gross total income (GTI) and then the deductions will be allowed. Let us now see the various incomes that are exempt from tax and the conditions to be satisfied in order to be eligible for exemptions.

**(1) Agricultural income [Section 10(1)]** – (i) Section 10(1) provides that agricultural income is not to be included in the total income of the assessee. The reason for totally exempting agricultural income from the scope of central income tax is that under the Constitution, the Parliament has no power to levy a tax on agricultural income.

(ii) **Indirect way of taxing agricultural income** - However, a method has been laid down to levy tax on agricultural income in an indirect way. This concept is known as partial integration of taxes. It is applicable to individuals, HUF, unregistered firms, AOP, BOI and artificial persons. Two conditions which need to be satisfied for partial integration are:

1. The net agricultural income should exceed ₹ 5,000 p.a., and
2. Non-agricultural income should exceed the maximum amount not chargeable to tax. (i.e., ₹ 5,00,000 for very senior citizens, ₹ 3,00,000 for senior citizens, ₹ 2,50,000 for all other individuals and HUFs).

It may be noted that aggregation provisions do not apply to company, firm assessed as such (FAS), co-operative society and local authority. The object of aggregating the net agricultural income with non-agricultural income is to tax the non-agricultural income at higher rates.

Tax calculation in such cases is as follows:

- Step 1:** Add non-agricultural income with net agricultural income. Compute tax on the aggregate amount.
- Step 2:** Add net agricultural income and the maximum exemption limit available to the assessee (i.e. ₹ 2,50,000 / ₹ 3,00,000 / ₹ 5,00,000). Compute tax on the aggregate amount.
- Step 3:** Deduct the amount of income tax calculated in step 2 from the income tax calculated in step 1 i.e. Step 1 – Step 2.
- Step 4:** The sum so arrived at shall be increased by education cess @2% and secondary and higher education cess @1%.

The above concept can be clearly understood with the help of the following illustrations:

**Illustration 1**

*Mr. X, a resident, has provided the following particulars of his income for the P.Y. 2014-15.*

- |   |              |
|---|--------------|
| i. Income from salary (computed)          | - ₹ 2,30,000 |
| ii. Income from house property (computed) | - ₹ 2,00,000 |

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iii. *Agricultural income from a land in Jaipur* - ₹ 1,80,000

iv. *Expenses incurred for earning agricultural income* - ₹ 1,20,000

Compute his tax liability assuming his age is -

(a) 45 years

(b) 70 years

**Solution**

#### Computation of total income of Mr. X for the A.Y.2015-16

##### (a) Computation of tax liability (age 45 years)

For the purpose of partial integration of taxes, Mr. X has satisfied both the conditions i.e.

1. Net agricultural income exceeds ₹ 5,000 p.a., and
2. Non-agricultural income exceeds the basic exemption limit of ₹ 2,50,000.

His tax liability is computed in the following manner:

Particulars	₹	₹
Income from salary		2,30,000
Income from house property		2,00,000
Net agricultural income [₹ 1,80,000 – ₹ 1,20,000]	60,000	
Less: Exempt under section 10(1)	(60,000)	-
<b>Gross Total Income</b>		<b>4,30,000</b>
Less: Deductions under Chapter VI-A		-
<b>Total Income</b>		<b>4,30,000</b>

Step 1: ₹ 4,30,000 + ₹ 60,000 = ₹ 4,90,000.

Tax on ₹ 4,90,000 = ₹ 24,000

Step 2: ₹ 60,000 + ₹ 2,50,000 = ₹ 3,10,000.

Tax on ₹ 3,10,000 = ₹ 6,000 (i.e. 10% of ₹ 60,000)

Step 3: ₹ 24,000 – ₹ 6,000 = ₹ 18,000.

Step 4 : Total tax payable = ₹ 18,000 - ₹ 2,000 (Rebate u/s 87A) = ₹ 16,000

= ₹ 16,000 + 2% of ₹ 16,000 + 1% of ₹ 16,000 = ₹ 16,480.

##### (b) Computation of tax liability (age 70 years)

For the purpose of partial integration of taxes, Mr. X has satisfied both the conditions i.e.

1. Net agricultural income exceeds ₹ 5,000 p.a., and

2. Non-agricultural income exceeds the basic exemption limit of ₹ 3,00,000.

His tax liability is computed in the following manner:

Step 1: ₹ 4,30,000 + ₹ 60,000	= ₹ 4,90,000.
Tax on ₹ 4,90,000	= ₹ 19,000 (i.e. 10% of ₹ 1,90,000)
Step 2: ₹ 60,000 + ₹ 3,00,000	= ₹ 3,60,000.
Tax on ₹ 3,60,000	= ₹ 6,000 (i.e. 10% of ₹ 60,000)
Step 3: ₹ 19,000 – ₹ 6,000	= ₹ 13,000.
Step 4: Total tax payable	= ₹ 13,000 – ₹ 2,000 (Rebate u/s 87A)
	= ₹ 11,000 + 2% of ₹ 11,000 + 1% of ₹ 11,000 = ₹ 11,330.

(iii) **Definition of agricultural income [Section 2(1A)]:** This definition is very wide and covers the income of not only the cultivators but also the land holders who might have rented out the lands. Agricultural income may be received in cash or in kind.

**Three ways:** Agricultural income may arise in any one of the following three ways:-

- (1) It may be rent or revenue derived from land situated in India and used for agricultural purposes.
- (2) It may be income derived from such land through agriculture or the performance of a process ordinarily employed by a cultivator or receiver of rent in kind to render the produce fit to be taken to the market or through the sale of such agricultural produce in the market.
- (3) Lastly, agricultural income may be derived from any farm building required for agricultural operations.

Now let us take a critical look at the following aspects:

- (1) **Land has to be situated in India** - If agricultural lands are situated in a foreign State, the entire income would be taxable.
- (2) **“Agriculture” and “agricultural purposes”** - These terms have not been defined in the Act. However, cultivation of a field involving expenditure of human skill and labour on the land can be broadly termed as agriculture.
  - (a) “Agriculture” means tilling of the land, sowing of the seeds and similar operations. These are basic operations and require the expenditure of human skill and labour on land itself. Those operations which the agriculturists have to resort to and which are absolutely necessary for the purpose of effectively raising produce from the land are the basic operations.
  - (b) Operations to be performed after the produce sprouts from the land (*e.g.*, weeding, digging etc.) are subsequent operations. These subsequent operations would be agricultural operations only when taken in conjunction with and as a continuation of the basic operations. Simply performing these subsequent operations without raising such products is not characterized as agriculture.

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- (c) "Agriculture" comprises within its scope the basic as well as the subsidiary operations regardless of the nature of the produce raised on the land. These produce may be grain, fruits or vegetables necessary for *sustenance* of human beings including plantation and groves or grass or pasture for consumption of beasts or articles of luxury such as betel, coffee, tea, spices, tobacco or commercial crops like cotton flax, jute hemp and indigo. The term comprises of products of land having some utility either for consumption or for trade and commerce and would include forest products such as sal, tendu leaves etc.
- (d) However, the term 'agriculture' cannot be extended to all activities which have some distant relation to land like dairy farming, breeding and rearing of live stock, butter and cheese making and poultry farming. This aspect is discussed in detail later on.

(3) **Income from nursery** - In the past, there have been court rulings that only if a nursery is maintained by carrying out the basic operations on land and subsequent operations in continuation thereof, income from such nursery would be treated as agricultural income and would qualify for exemption under section 10(1). The Supreme Court has, in *CIT v. Raja Benoy Kumar Sahas Roy (1957) 32 ITR 466*, held that the basic operations must be performed before any income can be called agricultural income. The basic operations involve cultivation of the ground, in the sense of tilling of the land, sowing of the seeds, planting and other similar operations on the land. Such basic operations demand the expenditure of human labour and skill upon the land itself and further, they are directed to make the crop sprout from the land. Therefore, income derived from sale of plants grown directly in pots would not be treated as agricultural income.

However, the Madras High Court, in *CIT v. Soundarya Nursery (2000) 241 ITR 530*, observed that nursing activity involves carrying out of several operations on land before the saplings were transplanted in suitable containers including pots and thereafter kept in shade or green house for further operation and growth. Therefore, income arising from nursery should be considered as agricultural income.

*Explanation 3* to section 2(1A) provides that the income derived from saplings or seedlings grown in a nursery would be deemed to be agricultural income, whether or not the basic operations were carried out on land. This Explanation ratifies the view taken by the Madras High Court in favour of the taxpayer.

(4) **Process ordinarily employed** - The process to which the agricultural produce is subject should be a process which is ordinarily employed by a cultivator. It may be manual or mechanical. However, it must be employed to render the produce fit to be taken to the market. For example, before making rice fit to be taken to the market we have to remove the basic grain from the hay, we have to remove the chaff from the grain, we have to properly filter them, we have to remove stones etc. and we have to pack the grain in gunny bags. In that condition alone the rice can be taken to the market and sold. This process of making the rice ready for the market may involve manual operations or mechanical operations. All these operations constitute the process ordinarily employed to make the product fit for the market. The produce must retain its original character in spite of the processing unless there is no

market for selling it in that condition.

**Explanation regarding gains arising on the transfer of urban agricultural land** - the capital gains arising from the transfer of such urban agricultural land would not be treated as agricultural income under section 10 but will be taxable under section 45.

**Example:** Suppose A sells agricultural land situated in New Delhi for ₹ 10 lakh and makes a surplus of ₹ 8 lakh over its cost of acquisition. This surplus will not constitute agricultural income exempt under section 10(1) and will be taxable under section 45.

**(5) Income from farm building** - Income from any farm building which satisfies the following conditions would be agricultural income and would consequently be exempt from tax. Income derived from any such building arising from any other use (other than those discussed below) shall not be agricultural income.

- (a) The building should be on or in the immediate vicinity of the agricultural land;
- (b) It should be owned and occupied by the receiver of the rent or revenue of any such land or occupied by the cultivator or the receiver of rent in kind of any land with respect to which land or the produce of which land the process discussed above is carried on;
- (c) The receiver of the rent or revenue or the cultivator or the receiver of rent in kind should, by reason of his connection with such land require it as a dwelling house or other out building.

In addition to the above three conditions any one of the following two conditions should also be satisfied:

- (i) The land should either be assessed to land revenue in India or be subject to a local rate assessed and collected by the officers of the Government as such or;
- (ii) Where the land is not so assessed to land revenue in India or is not subject to local rate:-
  - (a) It should not be situated in any area as comprised within the jurisdiction of a municipality or a cantonment board and which has a population not less than 10,000.
  - (b) It should not be situated in any area within such distance, measured aerially, in relation to the range of population according to the last preceding census as shown hereunder –

	Shortest aerial distance from the local limits of a municipality or cantonment board referred to in item (a)	Population according to the last preceding census of which the relevant figures have been published before the first day of the previous year.
(i)	2 kilometers	> 10,000 ≤ 1,00,000
(ii)	6 kilometers	> 1,00,000 ≤ 10,00,000
(iii)	8 kilometers	> 10,00,000



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#### Example

	Area	Shortest aerial distance from the local limits of a municipality or cantonment board referred to in item (a)	Population according to the last preceding census of which the relevant figures have been published before the first day of the previous year.	Is the land situated in this area an agricultural land?
(i)	A	1 km	9,000	Yes
(ii)	B	1.5 kms	12,000	No
(iii)	C	2 kms	11,00,000	No
(iv)	D	3 kms	80,000	Yes
(v)	E	4 kms	3,00,000	No
(v)	F	5 kms	12,00,000	No
(vi)	G	6 kms	8,000	Yes
(vii)	H	7 kms	4,00,000	Yes
(viii)	I	8 kms	10,50,000	No
(ix)	J	9 kms	15,00,000	Yes

**(iv) Indirect connection with the land** - We have seen above that agricultural income is exempt, whether it is received by the tiller or the landlord. However, non-agricultural income does not become agricultural merely on account of its indirect connection with the land. The following examples will illustrate the above point.

1. A rural society had as its principal business the selling on behalf of its member societies, butter made by these societies from cream sold to them by farmers. The making of butter was a factory process separated from the farm. It was held that the butter resulting from the factory operations separated from the farm was not an agricultural product and the society was, therefore, not entitled to exemption from income tax.
2. X was the managing agent of a company. He was entitled for a commission at the rate of 10% p.a. on the annual net profits of the company. A part of the company's income was agricultural income. X claimed that since his remuneration was calculated with reference to income of the company, part of which was agricultural income, such part of the commission as was proportionate to the agricultural income was exempt from income tax. It was held that X received remuneration under a contract for personal service calculated on the amount of profits earned by the company and that remuneration was not an agricultural income.
3. Y owned 100 acres of agricultural land, a part of which was used as pasture for cows. The lands were purely maintained for manuring and other purposes connected with agriculture and only the surplus milk after satisfying the assessee's needs was sold. The

question arose whether income from such sale of milk was agricultural income. It was held that the regularity with which the sales of milk were effected and quantity of milk sold showed that the assessee carried on regular business of producing milk and selling it as a commercial proposition. Hence, it was not agricultural income.

4. B was a shareholder in certain tea companies, 60% of whose income was exempt from tax as agricultural income. She claimed that 60% of the dividend received by her on her shares in those companies was also exempt from tax as agricultural income. It was held that dividend is derived from the investment made in the shares of the company and is not an agricultural income.
  5. In regard to forest trees of spontaneous growth which grow on the soil unaided by any human skill and labour there is no cultivation of the soil at all. Even though operations in the nature of forestry operations performed by the assessee may have the effect of nursing and fostering the growth of such forest trees, it cannot constitute agricultural operations. Income from the sale of such forest trees of spontaneous growth do not, therefore, constitute agricultural income.
- (v) For better understanding of the concept, certain examples of agricultural income and non-agricultural income are given below:

#### **Agricultural income**

1. Income derived from the sale of seeds.
2. Income from growing of flowers and creepers.
3. Rent received from land used for grazing of cattle required for agricultural activities.
4. Income from growing of bamboo.

#### **Non-agricultural income**

1. Income from breeding of livestock.
2. Income from poultry farming.
3. Income from fisheries.
4. Income from dairy farming.

**(vi) Apportionment in certain cases** - Where the agricultural produce like tea, cotton, tobacco, sugarcane etc. are subjected to a manufacturing process and the manufactured product is sold, the profit on such sales will consist of agricultural income as well as business income. That portion of the profit representing agricultural income will be exempted. For this purpose, Rules 7, 7A, 7B & 8 of Income-tax Rules, 1962 provides the basis of apportionment.

**(a) Rule 7 - Income from growing and manufacturing of any product other than tea** - Where income is partially agricultural income and partially income chargeable to income-tax under the head 'profits and gains of business', the market value of any agricultural produce which has been raised by the assessee or received by him as rent in kind and which has been utilised as raw material in such business or the sale receipts of which are included in the

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accounts of the business shall be deducted. No further deduction shall be made in respect of any expenditure incurred by the assessee as a cultivator or receiver of rent in kind.

**Determination of market value** - There are two possibilities here :

- (a) The agricultural produce is capable of being sold in the market either in its raw stage or after application of any ordinary process to make it fit to be taken to the market. In such a case, the value calculated at the average price at which it has been so sold during the relevant previous year will be the market value.
- (b) It is possible that the agricultural produce is not capable of being ordinarily sold in the market in its raw form or after application of any ordinary process. In such case the market value will be the total of the following:—
  - (i) The expenses of cultivation;
  - (ii) The land revenue or rent paid for the area in which it was grown; and
  - (iii) Such amount as the Assessing Officer finds having regard to the circumstances in each case to represent at reasonable profit.

#### Illustration 2

*Mr. B grows sugarcane and uses the same for the purpose of manufacturing sugar in his factory. 30% of sugarcane produce is sold for ₹ 10 lacs, and the cost of cultivation of such sugarcane is ₹ 5 lacs. The cost of cultivation of the balance sugarcane (70%) is ₹ 14 lacs and the market value of the same is ₹ 22 lacs. After incurring ₹ 1.5 lacs in the manufacturing process on the balance sugarcane, the sugar was sold for ₹ 25 lacs. Compute B's business income and agricultural income.*

#### Solution

Income from sale of sugarcane gives rise to agricultural income and from sale of sugar gives rise to business income.

$$\begin{aligned}\text{Business income} &= \text{Sales} - \text{Market value of 70\% of sugarcane produce} - \text{Manufacturing expenses} \\ &= ₹ 25 \text{ lacs} - ₹ 22 \text{ lacs} - ₹ 1.5 \text{ lacs} = ₹ 1.5 \text{ lacs.} \\ \text{Agricultural income} &= \text{Market value of sugarcane produce} - \text{Cost of cultivation} \\ &= [₹ 10 \text{ lacs} + ₹ 22 \text{ lacs}] - [₹ 5 \text{ lacs} + ₹ 14 \text{ lacs}] \\ &= ₹ 32 \text{ lacs} - ₹ 19 \text{ lacs} \\ &= ₹ 13 \text{ lacs.}\end{aligned}$$

**(b) Rule 7A – Income from growing and manufacturing of rubber** – This rule is applicable when income derived from the sale of latex or cenex or latex based crepes or brown crepes manufactured from field latex or coagulum obtained from rubber plants grown by the seller in India. In such cases 35% profits on sale is taxable as business income under the

head profits and gains from business or profession, and the balance 65% is agricultural income and is exempt.

### Illustration 3

*Mr. C manufactures latex from the rubber plants grown by him in India. These are then sold in the market for ₹ 30 lacs. The cost of growing rubber plants is ₹ 10 lacs and that of manufacturing latex is ₹ 8 lacs. Compute his total income.*

### Solution

The total income of Mr. C comprises of agricultural income and business income.

Total profits from the sale of latex                      = ₹ 30 lacs – ₹ 10 lacs – ₹ 8 lacs = ₹ 12 lacs.

Agricultural income    = 65% of ₹ 12 lacs. = ₹ 7.8 lacs

Business income     = 35% of ₹ 12 lacs. = ₹ 4.2 lacs

**(c) Rule 7B – Income from growing and manufacturing of coffee** – (a) In case of income derived from the sale of coffee grown and cured by the seller in India, 25% profits on sale is taxable as business income under the head “Profits and gains from business or profession”, and the balance 75% is agricultural income and is exempt. (b) In case of income derived from the sale of coffee grown, cured, roasted and grounded by the seller in India, with or without mixing chicory or other flavouring ingredients, 40% profits on sale is taxable as business income under the head “Profits and gains from business or profession”, and the balance 60% is agricultural income and is exempt.

**(d) Rule 8 - Income from growing and manufacturing of tea** - This rule applies only in cases where the assessee himself grows tea leaves and manufactures tea in India. In such cases 40% profits on sale is taxable as business income under the head “Profits and gains from business or profession”, and the balance 60% is agricultural income and is exempt.

### (2) Amounts received by a member from the income of the HUF [Section 10(2)]

- (i) As seen in the first Chapter, a HUF is a ‘person’ and hence a unit of assessment under the Act. Income earned by the HUF is assessable in its own hands.
- (ii) In order to prevent double taxation of one and the same income, once in the hands of the HUF which earns it and again in the hands of a member when it is paid out to him, section 10(2) provides that members of a HUF do not have to pay tax in respect of any amounts received by them from the family.
- (iii) The exemption applies only in respect of a payment made by the HUF to its member
  - (1) out of the income of the family or
  - (2) out of the income of the impartible estate belonging to the family.

**(3) Share income of a partner [Section 10(2A)]** - This clause exempts from tax a partner’s share in the total income of the firm. In other words, the partner’s share in the total income of the firm determined in accordance with the profit-sharing ratio will be exempt from tax.

**Taxability of partner's share, where the income of the firm is exempt under Chapter III / deductible under Chapter VI-A [Circular No. 8/2014 dated 31.03.2014]**

*Section 10(2A) provides that a partner's share in the total income of a firm which is separately assessed as such shall not be included in computing the total income of the partner. In effect, a partner's share of profits in such firm is exempt from tax in his hands.*

*Sub-section (2A) was inserted in section 10 by the Finance Act, 1992 with effect from 1.4.1993 consequent to change in the scheme of taxation of partnership firms. Since A.Y.1993-94, a firm is assessed as such and is liable to pay tax on its total income. A partner is, therefore, not liable to tax once again on his share in the said total income.*

*An issue has arisen as to the amount which would be exempt in the hands of the partners of a partnership firm, in cases where the firm has claimed exemption/deduction under Chapter III or Chapter VI-A.*

*The CBDT has clarified that the income of a firm is to be taxed in the hands of the firm only and the same can under no circumstances be taxed in the hands of its partners. Therefore, the entire profit credited to the partners' accounts in the firm would be exempt from tax in the hands of such partners, even if the income chargeable to tax becomes Nil in the hands of the firm on account of any exemption or deduction available under the provisions of the Act.*

**(4) Exemption to non-residents and person resident outside India [Section 10(4)]**

- (i) This clause provides that in the case of a non-resident, any income by way of interest on Central Government securities as may be prescribed will be exempt. Even income by way of premium on the redemption of such bonds is exempt.
- (ii) However, the Central Government shall not notify any such bonds or securities after 1.6.2002. Hence, this exemption will no more be available in respect of any further issue of bonds or securities on or after the 1.6.2002.
- (iii) In the case of an individual who is a person resident outside India, as defined in Foreign Exchange Management Act, 1999 (FEMA, 1999), any income by way of interest on moneys standing to his credit in a Non-resident (External) Account (NRE A/c) in any bank in India will be exempt, subject to fulfillment of certain conditions.
- (iv) In this context, it may be noted that the joint holders of the NRE Accounts do not constitute an AOP by merely having these accounts in joint names. The benefit of exemption under section 10(4)(ii) will be available to such joint account holders, subject to fulfillment of other conditions contained in that section by each of the individual joint account holders.

**(5) Interest on savings certificates [Section 10(4B)]**

- (i) An individual, being a citizen of India or a person of Indian origin, who is non-resident shall be entitled for exemption in respect of interest on such saving certificates issued before 1.6.2002 by the Central Government and notified by it in the Official Gazette in this behalf.

- (ii) However, to claim such exemption, the individual should have subscribed to such certificates in convertible foreign exchange remitted from a country outside India in accordance with the provisions of the FEMA, 1999.

**(6) Leave travel concession [Section 10(5)]**

- (i) This clause exempts the leave travel concession (LTC) received by employees from their employers for proceeding to any place in India,
  - (a) either on leave or
  - (b) after retirement from service or
  - (c) after termination of his service.
- (ii) The benefit is available to individuals - citizens as well as non-citizens - in respect of travel concession or assistance for himself or herself and for his/her family- *i.e.*, spouse and children of the individual and parents, brothers and sisters of the individual or any of them wholly or mainly dependent on the individual.
- (iii) **Limit of exemption** - The exemption in all cases will be limited to the amount actually spent subject to such conditions as specified in Rule 2B regarding the ceiling on the number of journeys for the place of destination.

Under Rule 2B, exemption will be available in respect of 2 journeys performed in a block of 4 calendar years commencing from the calendar year 1986. Where such travel concession or assistance is not availed by the individual during any block of 4 calendar years, one such unavailed LTC will be carried forward to the immediately succeeding block of 4 calendar years and will be eligible for exemption.

**Example:** An employee does not avail any LTC for the block 2010-13. He avails it during 2014. He is allowed to carry forward maximum one such holiday to be used in the succeeding block. Therefore, he will be eligible for exemption and two more journeys can be further availed.

- (iv) **Monetary limits** - Where the journey is performed on or after the 1.10.1997, the amount exempted under section 10(5) in respect of the value of LTC shall be the amount actually incurred on such travel subject to the following conditions:
  - (1) where it is performed by air, an amount not exceeding the air economy fare of the National Carrier by the shortest route to the place of destination;
  - (2) where places of origin of journey and destination are connected by rail and the journey is performed by any mode of transport other than by air an amount not exceeding the air-conditioned first class rail fare by the shortest route to the place of destination; and
  - (3) where the places of origin of journey and destination or part thereof are not connected by rail, the amount eligible for exemption shall be,—
    - (A) where a recognised public transport system exists, an amount not exceeding

the 1st class or deluxe class fare, as the case may be, on such transport by the shortest route to the place of destination ; and

- (B) where no recognised public transport system exists, an amount equivalent to the air-conditioned first class rail fare, for the distance of the journey by the shortest route, as if the journey had been performed by rail.

**Note:** The exemption referred to shall not be available to more than two surviving children of an individual after 1.10.1998. This restrictive sub-rule shall not apply in respect of children born before 1.10.1998 and also in case of multiple births after one child.

#### Illustration 4

*Mr. D went on a holiday on 25.12.2014 to Delhi with his wife and three children (one son – age 5 years; twin daughters – age 2 years). They went by flight (economy class) and the total cost of tickets reimbursed by his employer was ₹ 60,000 (₹ 45,000 for adults and ₹ 15,000 for the three minor children). Compute the amount of LTC exempt.*

#### Solution

Since the son's age is more than the twin daughters, Mr. D can avail exemption for all his three children. The restriction of two children is not applicable to multiple births after one child. The holiday being in India and the journey being performed by air (economy class), the entire reimbursement met by the employer is fully exempt.

#### Illustration 5

*In the above illustration 4, will there be any difference if among his three children the twins were 5 years old and the son 3 years old? Discuss.*

#### Solution

Since the twins' age is more than the son, Mr. D cannot avail for exemption for all his three children. LTC exemption can be availed in respect of only two children. Taxable

$$\text{LTC} = 15,000 \times \frac{1}{3} = ₹ 5,000 .$$

LTC exempt is only ₹ 55,000 (i.e. ₹ 60,000 – ₹ 5,000)

- (7) Exemption in the case of individuals, who are not citizens of India [Section 10(6)]-**  
Individual assessee who are not citizens of India are entitled to certain exemptions:

- (i) Section 10(6)(ii) grants exemption to a person in respect of the remuneration received by him for services as an official of an embassy, high commission, legation, consulate or the trade representation of a foreign State or as a member of the staff of any of these officials.

#### Conditions

- (a) The remuneration received by our corresponding Government officers resident in such foreign countries should be exempt.

- (b) The above-mentioned officers should be the subjects of the respective countries and should not be engaged in any other business or profession or employment in India.
- (ii) Section 10(6)(vi) provides that remuneration received by a foreign national as an employee of a foreign enterprise for service rendered by him during his stay in India is also exempt from tax.

**Conditions**

- (1) The foreign enterprise is not engaged in a business activity in India;
  - (2) The employee's stay in India does not exceed a total of 90 days in the previous year;
  - (3) The remuneration is not liable to be deducted from the employer's income chargeable to tax under the Act.
  - (iii) Section 10(6)(viii) provides that salary income received by or due to a non-citizen of India who is also non-resident for services rendered in connection with his employment on a foreign ship where his total stay in India does not exceed a total of 90 days in the previous year.
  - (iv) Section 10(6)(xi) provides that any remuneration received by employees of foreign Government from their respective Government during their stay in India in connection with their training in any establishment or office of the Government or any public sector undertaking is exempt from tax. For this purpose, the expression 'public sector undertaking' will cover Statutory Corporations; companies wholly owned by the Central Government or State Government or jointly by the Central and State Government and subsidiaries of such companies, societies registered under the Societies Registration Act, 1860 or any other similar law, which are wholly financed by the Central Government or State Government or jointly by the Central or State Government.
- (8) Tax on royalty or fees for technical services derived by foreign companies [Section 10(6A)]** - The benefit of exemption under this section is available to foreign companies only. As per this clause, tax paid by the Government or by an Indian concern on behalf of a foreign company is exempt in the hands of such foreign company provided all the following conditions are satisfied:
- (i) Such tax must have been payable by the foreign company in respect of income received from the Government or the Indian concern by way of royalty or fees for technical services.
  - (ii) Such income by way of royalty or fees for technical services must have been received in pursuance of an agreement made by the foreign company with the Government or the Indian concern on or after 1.4.1976 but before 1.6.2002 and such agreement must have been approved by the Central Government. However, where the agreement relates to a subject matter which is included in the industrial policy of the Government and such agreement is in accordance with that policy, no approval of the Central Government is necessary.



(9) **Tax paid on behalf of non-resident [Section 10(6B)]** – This clause provides that the amount of tax paid by Government or an Indian concern on behalf of a non-resident or a foreign company in respect of its income will not be included in computing the total income of such non-resident or foreign company in pursuance of an agreement entered before 1.6.2002 between the Central Government and the Government of foreign State or an international organisation under the terms of that agreement or of any related agreement which has been approved before 1.6.2002 by the Central Government.

(10) **Tax paid on behalf of foreign state or foreign enterprise on amount paid as consideration of acquiring aircraft, etc. on lease [Section 10(6BB)]** - Under this section, exemption is provided in respect of tax paid by an Indian company engaged in the business of operation of an aircraft, on income derived by the Government of a foreign State or a foreign enterprise as a consideration of acquiring an aircraft or aircraft engine on lease under an agreement entered into after 31.3.1997 but before 1.4.1999 or entered into after 31.3.2007 and approved by the Central Government.

However, payment for providing spares, facilities or services in connection with the operation of leased aircraft is not covered under this clause.

(11) **Income from projects connected with the security of India [Section 10(6C)]** - Any income arising to such foreign company as the Central Government may notify, by way of fees for technical services received in pursuance of an agreement entered into with that Government for providing services in or outside India in projects connected with security of India will be exempt. Such exemption is also available in respect of royalty for technical services arising to the foreign company.

(12) **Allowances payable outside India [Section 10(7)]** - Allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India for services rendered outside India are exempt from tax. Students may remember that in such cases under section 9(1)(iii), the income chargeable under the head 'Salaries' is deemed to accrue in India. The residential status of the recipient will, however, not affect this exemption.

(13) **Co-operative technical assistance programmes [Sections 10(8) and (9)]** - Individuals who are assigned duties in India in connection with any co-operative technical assistance programmes and projects would be exempt from tax on their receipts by way of:

- (a) remuneration received directly or indirectly from the Government of a foreign State for rendering such services; and
- (b) any other income accruing or arising outside India (but is not deemed to accrue or arise in India) in respect of which the individual is required to pay income-tax or other social security tax to the Government of that foreign State.

A similar exemption would be available under section 10(9) in respect of the income of any member of the family of any such individual referred to above provided that the income:

- (i) actually accrues outside India;

- (ii) cannot be deemed to accrue or arise in India; and
- (iii) in respect of which such member is required to pay income or social security tax to the Government of that foreign State.

**(14) Consultant remuneration [Sections 10(8A) and (8B)]** - Under clause (8A), any remuneration or fee received by a consultant, directly or indirectly, out of the funds made available to an international organisation (agency) under a technical assistance grant agreement with the agency and Government of a foreign State is exempted from income-tax. The expression "Consultant" means any individual who is either not a citizen of India or, being a citizen of India, is resident but not ordinarily resident, or any other person who is a non-resident and is engaged by the agency for rendering technical services in India in accordance with an agreement entered into by the Central Government and the State agency and the agreement relating to the engagements of the consultant is approved by the prescribed authority.

Under clause (8B), the remuneration received by an employee of the consultant is exempted from income-tax provided such employee is either not a citizen of India or, being a citizen of India, is resident but not ordinarily resident and the contract of his service is approved by the prescribed authority before the commencement of his service.

Section 10(9) discussed above exempts the income of any member of the family of any such individual as is referred to in clauses (8A) and (8B) accompanying him to India, which accrues or arises outside India, and in respect of which such member is required to pay any income or social security tax to the country of his origin.

**(15) Gratuity [Section 10(10)]**

1. Retirement gratuity received under the Pension Code Regulations applicable to members of the Defence Service is fully exempt from tax.
2. **Central / State Government Employees:** Any death cum retirement gratuity is fully exempt from tax.
3. **Non-government employees covered by the Payment of Gratuity Act, 1972**  
Any death cum retirement gratuity is exempt from tax to the extent of least of the following:
  - (i) ₹ 10,00,000
  - (ii) Gratuity actually received
  - (iii) 15 days' salary based on last drawn salary for each completed year of service or part thereof in excess of 6 months

**Note:** Salary for this purpose means basic salary and dearness allowance. No. of days in a month for this purpose, shall be taken as 26.

4. **Non-government employees not covered by the Payment of Gratuity Act, 1972**  
Any death cum retirement gratuity is exempt from tax to the extent of least of the

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following:

- (i) ₹ 10,00,000
- (ii) Gratuity actually received
- (iii) Half month's salary (based on last 10 months' average salary immediately preceding the month of retirement or death) for each completed year of service (fraction to be ignored)

**Note:** Salary for this purpose means basic salary and dearness allowance, if provided in the terms of employment for retirement benefits, forming part of salary and commission which is expressed as a fixed percentage of turnover.

Students must also note the following points:

- (1) Gratuity received during the period of service is fully taxable.
- (2) Where gratuity is received from 2 or more employers in the same year then aggregate amount of gratuity exempt from tax cannot exceed ₹ 10,00,000.
- (3) Where gratuity is received in any earlier year from former employer and again received from another employer in a later year, the limit of ₹ 10,00,000 will be reduced by the amount of gratuity exempt earlier.
- (4) The exemption in respect of gratuities would be available even if the gratuity is received by the widow, children or dependents of a deceased employee.

#### Illustration 6

*Mr. Ravi retired on 15.6.2014 after completion of 26 years 8 months of service and received gratuity of ₹ 6,00,000. At the time of retirement his salary was:*

Basic Salary	:	₹ 5,000 p.m.
Dearness Allowance	:	₹ 3,000 p.m. (60% of which is for retirement benefits)
Commission	:	1% of turnover (turnover in the last 12 months was ₹ 12,00,000)
Bonus	:	₹ 12,000 p.a.

*Compute his taxable gratuity assuming:*

- (a) *He is non-government employee and covered by the Payment of Gratuity Act 1972.*
- (b) *He is non-government employee and not covered by Payment of Gratuity Act 1972.*
- (c) *He is a Government employee.*

#### Solution

- (a) **He is covered by the Payment of Gratuity Act 1972.**

Gratuity received at the time of retirement	₹ 6,00,000
Less: Exemption under section 10(10)	

iii. 15 days salary based on last drawn salary for each completed year of service or part thereof in excess of 6 months

$$\frac{15}{26} \times \text{last drawn salary} \times \text{years of service}$$

$$\frac{15}{26} \times (\text{₹ } 5,000 + \text{₹ } 3,000) \times 27 = \quad \underline{\text{₹ } 1,24,615} \quad \underline{\text{₹ } 1,24,615}$$

Taxable Gratuity	₹ 4,75,385
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Less: Exemption under section 10(10) (Note 1)	₹ 1,01,400
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Taxable Gratuity	₹ 4,98,600
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iii. Half month's salary based on average salary of last 10 months preceding the month of retirement for each completed year of service.

$$\text{i.e. } \frac{1}{2} \times \text{Average salary} \times \text{years of service}$$

$$= \frac{1}{2} \times \frac{\left[ (5,000 \times 10) + (3,000 \times 60\% \times 10) + \left( 1\% \times 12,00,000 \times \frac{10}{12} \right) \right]}{10} \times 26$$

= ₹ 1,01,400

Less : Exemption under section 10(10)	₹ 6,00,000
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Taxable gratuity	Nil
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**(16) Payment in commutation of pension [Section 10(10A)]**

Pension is of two types: commuted and uncommuted.

**Uncommuted Pension:** Uncommuted pension refers to pension received periodically. It is fully taxable in the hands of both government and non-government employees.

**Commuted Pension:** Commuted pension means lump sum amount taken by commuting the whole or part of the pension. Its treatment is discussed below:

- (a) **Employees of the Central Government/local authorities/Statutory Corporation/members of the Defence Services:** Any commuted pension received is fully exempt from tax.
- (b) **Non-Government Employee:** Any commuted pension received is exempt from tax in the following manner:

**If the employee is in receipt of gratuity,**

Exemption =  $\frac{1}{3}$ rd of the amount of pension which he would have received had he commuted the whole of the pension.

$$= \left[ \frac{1}{3} \times \frac{\text{commuted pension received}}{\text{commutation \%}} \times 100\% \right]$$

**If the employee does not receive any gratuity**

Exemption =  $\frac{1}{2}$  of the amount of pension which he would have received had he commuted the whole of the pension.

$$= \left[ \frac{1}{2} \times \frac{\text{commuted pension received}}{\text{commutation \%}} \times 100\% \right]$$

**Note:**

- 1. Judges of the Supreme Court and High Court will be entitled to exemption of the commuted portion not exceeding  $\frac{1}{2}$  of the pension.
- 2. Any commuted pension received by an individual out of annuity plan of the Life Insurance Corporation of India (LIC) from a fund set up by that Corporation will be exempted.

**Illustration 7**

*Mr. Sagar retired on 1.10.2014 receiving ₹ 5,000 p.m. as pension. On 1.2.2015, he commuted 60% of his pension and received ₹ 3,00,000 as commuted pension. You are required to compute his taxable pension assuming:*

- a. *He is a government employee.*
- b. *He is a non-government employee, receiving gratuity of ₹ 5,00,000 at the time of retirement.*
- c. *He is a non-government employee and is in receipt of no gratuity at the time of retirement.*

**Solution**

**(a) He is a government employee.**

Uncommuted pension received (October – March)		₹ 24,000
[ (₹ 5,000 × 4 months) + (40% of ₹ 5,000 × 2 months)]		
Commuted pension received	₹ 3,00,000	
Less : Exempt u/s 10(10A)	<u>₹ 3,00,000</u>	<u>NIL</u>
Taxable pension		<u>₹ 24,000</u>

**(b) He is a non-government employee, receiving gratuity ₹ 5,00,000 at the time of retirement.**

Uncommuted pension received (October – March)		₹ 24,000
[(₹ 5,000 × 4 months) + (40% of ₹ 5,000 × 2 months)]		
Commuted pension received	₹ 3,00,000	
Less: Exempt u/s 10(10A)		
$\left( \frac{1}{3} \times \frac{₹ 3,00,000}{60\%} \times 100\% \right)$	<u>₹ 1,66,667</u>	<u>₹ 1,33,333</u>
Taxable pension		<u>₹ 1,57,333</u>

**(c) He is a non-government employee and is not in receipt of gratuity at the time of retirement.**

Uncommuted pension received (October – March)		₹ 24,000
[(₹ 5,000 × 4 months) + (40% of ₹ 5,000 × 2 months)]		
Commuted pension received	₹ 3,00,000	
Less: Exempt u/s 10(10A)		
$\left( \frac{1}{2} \times \frac{₹ 3,00,000}{60\%} \times 100\% \right)$	<u>₹ 2,50,000</u>	<u>₹ 50,000</u>
Taxable pension		<u>₹ 74,000</u>

**(17) Exemption of amount received by way of encashment of unutilised earned leave on retirement [Section 10(10AA)]** - It provides exemption in respect of amount received by way of encashment of unutilised earned leave by an employee at the time of his retirement whether on superannuation or otherwise. The provisions of this clause are mentioned below:

- (a) Government employees:** Leave salary received at the time of retirement is fully exempt from tax.
- (b) Non-government employees:** Leave salary received at the time of retirement is exempt from tax to the extent of least of the following :
  - (i) ₹ 3,00,000

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- (ii) Leave salary actually received
- (iii) 10 months' salary (on the basis of average salary of last 10 months )
- (iv) Cash equivalent of leave (based on last 10 months' average salary immediately preceding the date of retirement) to the credit of the employee at the time of retirement or death. Earned leave entitlement cannot exceed 30 days for every year of actual service rendered for the employer from whose service he has retired.

**Note:**

1. Leave salary received during the period of service is fully taxable.
2. Where leave salary is received from two or more employers in the same year, then the aggregate amount of leave salary exempt from tax cannot exceed ₹ 3,00,000.
3. Where leave salary is received in any earlier year from a former employer and again received from another employer in a later year, the limit of ₹ 3,00,000 will be reduced by the amount of leave salary exempt earlier.
4. Salary for this purpose means basic salary and dearness allowance, if provided in the terms of employment for retirement benefits and commission which is expressed as a fixed percentage of turnover.
5. 'Average salary' will be determined on the basis of the salary drawn during the period of ten months immediately preceding the date of his retirement whether on superannuation or otherwise.

**Illustration 8**

*Mr. Gupta retired on 1.12.2014 after 20 years 10 months of service, receiving leave salary of ₹ 5,00,000. Other details of his salary income are:*

*Basic Salary : ₹ 5,000 p.m. (₹ 1,000 was increased w.e.f. 1.4.2014)*

*Dearness Allowance : ₹ 3,000 p.m. (60% of which is for retirement benefits)*

*Commission : ₹ 500 p.m.*

*Bonus : ₹ 1,000 p.m.*

*Leave availed during service : 480 days*

*He was entitled to 30 days leave every year.*

*You are required to compute his taxable leave salary assuming:*

- (a) *He is a government employee.*
- (b) *He is a non government employee.*

**Solution**

(a) He is a government employee.

Leave Salary received at the time of retirement	₹ 5,00,000
Less : Exemption under section 10(10AA)	<u>₹ 5,00,000</u>
Taxable Leave salary	<u>Nil</u>

(b) He is a non-government employee

Leave Salary received at the time of retirement	₹ 5,00,000
Less : Exempt under section 10(10AA) [See Note below]	<u>₹ 26,400</u>
Taxable Leave Salary	<u>₹ 4,73,600</u>

**Note :** Exemption under section 10(10AA) is least of the following:

- |  |            |
|--|------------|
| (i) Leave salary received  | ₹ 5,00,000 |
| (ii) Statutory limit   | ₹ 3,00,000 |
| (iii) 10 months salary based on average salary of last 10 months |            |

$$\begin{aligned}
 &\text{i.e. } \left[ 10 \times \frac{\text{Salary of last 10 months i.e. Feb - Nov}}{10 \text{ months}} \right] \\
 &= \left[ 10 \times \frac{(5000 \times 8) + (4000 \times 2) + (60\% \times 3000 \times 10)}{10 \text{ months}} \right] \quad \text{₹ 66,000}
 \end{aligned}$$

- (iv) Cash equivalent of leave standing at the credit of the employee based on the average salary of last 10 months (max. 30 days per year of service)

$$\begin{aligned}
 \text{Leave Due} &= \text{Leave allowed} - \text{Leave taken} \\
 &= (30 \text{ days per year} \times 20 \text{ years}) - 480 \text{ days} \\
 &= 120 \text{ days} \\
 &\text{i.e. } \left[ \frac{\text{Leave due (in days)}}{30 \text{ days}} \times \text{Average salary p.m.} \right] \\
 &= \left[ \frac{120 \text{ days}}{30 \text{ days}} \times \frac{\text{₹ 66,000}}{10} \right] \quad \text{₹ 26,400}
 \end{aligned}$$

**(18) Retrenchment compensation [Section 10(10B)]** - Retrenchment compensation will be exempt from tax subject to the following limits:

- (a) Amount calculated in accordance with the provisions of section 25F of the Industrial Disputes Act, 1947



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i.e.  $\frac{15}{26} \times \text{Avg salary of last 3 mths} \times \text{Completed yrs of service and part thereof in excess of 6 mths}$

or

(b) An amount, not less than ₹ 5,00,000 as may be notified by the Central Government in this behalf,

whichever is lower.

The retrenchment compensation for this purpose means the compensation paid under Industrial Disputes Act, 1947 or under any Act, Rule, Order or Notification issued under any law. It also includes compensation paid on transfer of employment under section 25F or closing down of an undertaking under section 25FF of the Industrial Disputes Act, 1947.

The above limits will not be applicable to cases where the compensation is paid under any scheme approved by the Central Government for giving special protection to workmen under certain circumstances.

#### Illustration 9

*Mr. Garg received retrenchment compensation of ₹ 10,00,000 after 30 years 4 months of service. At the time of retrenchment, he was drawing basic salary ₹ 20,000 p.m.; dearness allowance ₹ 5,000 p.m. Compute his taxable retrenchment compensation.*

#### Solution

Retrenchment compensation received	₹ 10,00,000
Less : Exemption under section 10(10B) [See Note below]	<u>₹ 4,32,692</u>
Taxable retrenchment compensation	<u>₹ 5,67,308</u>

**Note :** Exemption is to the extent of least of the following :

- (i) Compensation actually received = ₹ 10,00,000
- (ii) Statutory Limit = ₹ 5,00,000
- (iii) Amount calculated in accordance with provisions of the Industrial Disputes Act, 1947

$$= \left[ \frac{15}{26} \times \frac{(20,000 \times 3) + (5,000 \times 3)}{3} \times 30 \text{ years} \right] = ₹ 4,32,692$$

**(19) Payments to Bhopal Gas Victims [Section 10(10BB)]** - Any payment made to a person under Bhopal Gas Leak Disaster (Processing of Claims) Act, 1985 and any scheme framed thereunder will be fully exempt. However, payments made to any assessee in connection with Bhopal Gas Leak Disaster to the extent he has been allowed a deduction under the Act on account of any loss or damage caused to him by such disaster will not be exempted.

**(20) Exemption of compensation received on account of disaster [Section 10(10BC)]**

- (i) This clause exempts any amount received or receivable as compensation by an individual or his legal heir on account of any disaster.
- (ii) Such compensation should be granted by the Central Government or a State Government or a local authority.
- (iii) However, exemption would not be available in respect of compensation for alleviating any damage or loss, which has already been allowed as deduction under the Act.
- (iv) "Disaster" means a catastrophe, mishap, calamity or grave occurrence in any area, arising from natural or manmade causes, or by accident or negligence. It should have the effect of causing -
  - (1) substantial loss of life or human suffering; or
  - (2) damage to, and destruction of, property; or
  - (3) damage to, or degradation of, environment.

It should be of such a nature or magnitude as to be beyond the coping capacity of the community of the affected area.

**(21) Voluntary Retirement Receipts [Section 10(10C)]** - Compensation received by an employee at the time of voluntary retirement is exempt from tax subject to the following conditions:

**Eligible Undertakings** - The employee of the following undertakings are eligible for exemption under this clause:

- (i) Public sector company
- (ii) Any other company
- (iii) An authority established under a Central/State or Provincial Act
- (iv) A local authority
- (v) A co-operative society
- (vi) An University established or incorporated under a Central/State or Provincial Act and an Institution declared to be an University by the University Grants Commission.
- (vii) An Indian Institute of Technology
- (viii) Such Institute of Management as the Central Government may, by notification in the Official Gazette, specify in this behalf
- (ix) Any State Government
- (x) The Central Government
- (xi) An institution, having importance throughout India or in any state or states, as the Central Government may specify by notification in the Official Gazette.

**Limit** : The maximum limit of exemption should not exceed ₹ 5 lakh.

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Such compensation should be at the time of his voluntary retirement or termination of his service, in accordance with any scheme or schemes of voluntary retirement or, in the case of public sector company, a scheme of voluntary separation. The exemption will be available even if such compensation is received in installments.

The schemes should be framed in accordance with such guidelines, as may be prescribed and should include the criteria of economic viability.

**Guidelines:** Rule 2BA prescribes the following guidelines for the purposes of the above clause:

1. It applies to an employee of the company or the authority, as the case may be, who has completed 10 years of service or completed 40 years of age.  
However, this requirement is not applicable in case of an employee of a public sector company under the scheme of voluntary separation framed by the company.
2. It applies to all employees by whatever name called, including workers and executives of the company or the authority except directors of a company or a cooperative society.
3. The scheme of voluntary retirement or separation must have been drawn to result in overall reduction in the existing strength of the employees of a company or the authority or a cooperative society.
4. The vacancy caused by the voluntary retirement or separation must not be filled up.
5. The retiring employee of a company shall not be employed in another company or concern belonging to the same management.
6. The amount receivable on account of voluntary retirement or separation of the employee must not exceed the amount equivalent to three months' salary for each completed year of service or salary at the time of retirement multiplied by the balance months of service left before the date of his retirement or superannuation.

**Note** - Where any relief has been allowed to any assessee under section 89 for any assessment year in respect of any amount received or receivable on his voluntary retirement or termination of service or voluntary separation, no exemption under section 10(10C) shall be allowed to him in relation to that assessment year or any other assessment year.

#### Illustration 10

*Mr. Dutta received voluntary retirement compensation of ₹ 7,00,000 after 30 years 4 months of service. He still has 6 years of service left. At the time of voluntary retirement, he was drawing basic salary ₹ 20,000 p.m.; Dearness allowance (which forms part of pay) ₹ 5,000 p.m. Compute his taxable voluntary retirement compensation, assuming that he does not claim any relief under section 89.*

#### Solution

Voluntary retirement compensation received	₹ 7,00,000
Less: Exemption under section 10(10C) [See Note below]	<u>₹ 5,00,000</u>
Taxable voluntary retirement compensation	<u>₹ 2,00,000</u>

**Note:** Exemption is to the extent of least of the following:

- (i) Compensation actually received = ₹ 7,00,000
- (ii) Statutory limit = ₹ 5,00,000
- (iii) Last drawn salary  $\times 3 \times$  completed years of service  
 $= (20,000 + 5,000) \times 3 \times 30 \text{ years} = ₹ 22,50,000$
- (iv) Last drawn salary  $\times$  remaining months of service  
 $= (20,000 + 5,000) \times 6 \times 12 \text{ months} = ₹ 18,00,000$

**(22) Income-tax paid by employer [Section 10(10CC)]** – This clause provides for exemption in the hands of an employee, being an individual deriving income by way of perquisites, not provided by way of monetary payment within the meaning of section 17(2). This applies where the tax on such income is actually paid by the employer, at the option of the employer, on behalf of such employee, notwithstanding anything contained in section 200 of the Companies Act, 1956.

This provision will provide relief to the employee if the employer is willing to bear the tax burden in respect of non-monetary perquisites provided by it to the employee as otherwise the tax so paid by employer would have been treated as income of the employee.

**(23) Receipts from LIC [Section 10(10D)]** - This clause clarifies that any sum received under a life insurance policy, including the sum allocated by way of bonus on such policy shall not be included in the total income of a person.

Recently, policies were introduced in respect of which the premium payable was very high. Sometimes, such premium was payable on a one-time basis. They are similar to deposits or bonds. With a view to ensure that such insurance policies are treated at par with other investment schemes, clause (10D) has been rationalised as follows –

**In respect of policies issued between 1.4.2003 and 31.3.2012**

- (i) Any sum received, under an insurance policy issued on or after 1.4.03 in respect of which the premium payable/paid during any of the years during the term of the policy exceeds 20% of the actual capital sum assured, shall not be exempt. Therefore, sum received in respect of such policies issued prior to 1.4.03 will continue to enjoy exemption.
- (ii) However, such sum received under such policy on the death of a person shall continue to be exempt.
- (iii) For the purpose of calculating the actual capital sum assured under this clause,
  - (a) the value of any premiums agreed to be returned or
  - (b) the value of any benefit by way of bonus or otherwise, over and above the sum actually assured,
 shall not be taken into account. Such premium or bonus may be received either by the

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policy holder or by any other person.

- (iv) Any sum received under section 80DD(3) shall not be exempt under this clause in addition to sum received under 80DDA(3) or under a Keyman insurance policy.

#### **In respect of policies issued on or after 1.4.2012**

- (i) Any sum received, under an insurance policy issued on or after 1.4.2012 in respect of which the premium payable/paid during any of the years during the term of the policy exceeds 10% of the actual capital sum assured, shall not be exempt.
- (ii) However, such sum received under such policy on the death of a person shall continue to be exempt.
- (iii) In respect of policies issued on or after 1<sup>st</sup> April, 2012, the actual capital sum assured shall mean the minimum amount assured under the policy on happening of the insured event at any time during the term of the policy, not taking into account -
  - (a) the value of any premiums agreed to be returned or
  - (b) the value of any benefit by way of bonus or otherwise, over and above the sum actually assured which is to be or may be received under the policy by any person,

In effect, in case the insurance policy has varied sum assured during the term of policy then the minimum of the sum assured during the life time of the policy shall be taken into consideration for calculation of the "actual capital sum assured" for the purpose of section 80C and section 10(10D), in respect of life insurance policies to be issued on or after 1<sup>st</sup> April, 2012.

- (iv) Any sum received under section 80DD(3) or section 80DDA(3) shall not be exempt. Further, any sum received under a Keyman insurance policy shall also not be exempt.

*Explanation 1* to section 10(10D) defines "Keyman insurance policy" as a life insurance policy taken by one person on the life of another person who is or was the employee of the first-mentioned person or is or was connected in any manner whatsoever with the business of the first-mentioned person. The scope of the term "keyman insurance policy" has now been amplified to include a keyman insurance policy which has been assigned to any person during its term, with or without consideration. Therefore, such policies shall continue to be treated as a keyman insurance policy even after the same is assigned to the keyman. Consequently, the sum received by the keyman on such policies, being "keyman insurance policies", would not be exempt under section 10(10D).

#### **In respect of policies issued on or after 1.4.2013**

Any sum received under a life insurance policy including the sum allocated by way of bonus on such policy would be exempt, where the policy is issued on or after 1<sup>st</sup> April, 2013 and is for insurance on life of any person, who is –

- (1) a person with disability or person with severe disability as referred to in section 80U; or
- (2) suffering from disease or ailment as specified in the rules made under section 80DDB,

and the premium payable for any of the years does not exceed 15% of minimum capital sum assured.

Where the insurance is on the life of any person, other than the persons mentioned above, exemption would be available only if the premium payable for any of the years during the term of the policy does not exceed 10% of "minimum capital sum assured" under the policy on the happening of the insured event at any time during the term of the policy.

**(24) Payment from provident funds [Sections 10(11) and (12)]** - The following payments received by an assessee will be fully exempt from tax:

- (a) Provident Fund (PF) to which Provident Fund Act, 1925, applies; or
- (b) Public Provident Fund.
- (c) Accumulated balance payable to an employee participating in a RPF (subject to certain conditions).

The conditions for the purpose of RPF above are as follows:

- (i) The employee should have rendered continuous service with the employer from whom the amount is received for a period of at least five years; or
- (ii) Where the employee had not rendered such continuous service the reason for the termination of his service should have been his ill-health or contraction or discontinuance of employer's business or any other cause beyond the control of the employee.

If such conditions are not satisfied the payments become taxable in the hands of the employee.

**(25) Payment from superannuation funds [Section 10(13)]** - Any payment received by any employee from an approved superannuation fund shall be entirely excluded from his total income if the payment is made

- (a) on the death of a beneficiary;
- (b) to an employee in lieu or in commutation of an annuity on his retirement at or after a specified age or on his becoming incapacitated prior to such retirement; or
- (c) by way of refund of contribution on the death of a beneficiary; or
- (d) by way of contribution to an employee on his leaving the service in connection with which the fund is established otherwise than by retirement at or after a specified age or his becoming incapacitated prior to such retirement.

In the case of (d) above the amount of exemption will be to the extent the payment made does not exceed the contribution made prior to 1-4-1962 and the interest thereon.

**(26) House rent allowance (HRA) [Section 10(13A)]** - HRA is a special allowance specifically granted to an employee by his employer towards payment of rent for residence of the employee. HRA granted to an employee is exempt to the extent of least of the following:

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Metro Cities (i.e. Delhi, Kolkata, Mumbai, Chennai)	Other Cities
1) HRA actually received.	1) HRA actually received
2) Rent paid-10% of salary for the relevant period	2) Rent paid - 10% of salary for the relevant period
3) 50% of salary for the relevant period	3) 40% of salary for the relevant period

**Note:** 1. Exemption is not available to an assessee who lives in his own house, or in a house for which he has not incurred the expenditure of rent.

2. Salary for this purpose means basic salary, dearness allowance, if provided in terms of employment and commission as a fixed percentage of turnover.

3. Relevant period means the period during which the said accommodation was occupied by the assessee during the previous year.

#### Illustration 11

*Mr. Raj Kumar has the following receipts from his employer:*

(1) Basic pay	₹ 3,000 p.m.
(2) Dearness allowance (D.A.)	₹ 600 p.m.
(3) Commission	₹ 6,000 p.a.
(4) Motor car for personal use (expenditure met by the employer)	₹ 500 p.m.
(5) House rent allowance	₹ 900 p.m.

*Find out the amount of HRA eligible for exemption to Mr. Raj Kumar assuming that he paid a rent of ₹ 1,000 p.m. for his accommodation at Kanpur. DA forms part of salary for retirement benefits.*

#### Solution:

HRA received	₹ 10,800
Less: Exempt under section 10(13A) [Note 1]	<u>₹ 7,680</u>
Taxable HRA	<u>₹ 3,120</u>

**Note 1:** Exemption shall be least of the following three limits:

- the actual amount received (₹ 900 × 12) = ₹ 10,800
- excess of the actual rent paid by the assessee over 10% of his salary  
 = Rent Paid - 10% of salary for the relevant period  
 = (₹ 1,000 × 12) - 10% of [(₹ 3,000 + ₹ 600) × 12] = ₹ 12,000 - ₹ 4,320 = ₹ 7,680
- 40% salary as his accommodation is situated at Kanpur  
 = 40% of [(₹ 3,000 + ₹ 600) × 12] = ₹ 17,280

**Note:** For the purpose of exemption under section 10(13A), salary includes dearness allowance only when the terms of employment so provide, but excludes all other allowances and perquisites.

**(27) Special allowances to meet expenses relating to duties or personal expenses [Section 10(14)]** - This clause provides for exemption (as per Rule 2BB) in respect of the following:

- (i) Special allowances or benefit not being in the nature of a perquisite, specifically granted to meet expenses incurred wholly, necessarily and exclusively in the performance of the duties of an office or employment of profit. For the allowances under this category, there is no limit on the amount which the employee can receive from the employer, but whatever amount is received should be fully utilized for the purpose for which it was given to him.
- (ii) Special allowances granted to the assessee either to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at the place where he ordinarily resides or to compensate him for the increased cost of living. For the allowances under this category, there is a limit on the amount which the employee can receive from the employer. Any amount received by the employee in excess of these specified limits will be taxable in his hands as income from salary for the year. It does not matter whether the amount which is received is actually spent or not by the employee for the purpose for which it was given to him.

**Rule 2BB**

The following allowances have been prescribed in Rule 2BB:

**Allowances prescribed for the purposes of section 10(14)(i)**

- (a) any allowance granted to meet the cost of travel on tour or on transfer (Travelling Allowance);
- (b) any allowance, whether granted on tour or for the period of journey in connection with transfer, to meet the ordinary daily charges incurred by an employee on account of absence from his normal place of duty;
- (c) any allowance granted to meet the expenditure incurred on conveyance in performance of duties of an office or employment of profit (Conveyance Allowance);
- (d) any allowance granted to meet the expenditure incurred on a helper where such helper is engaged in the performance of the duties of an office or employment of profit (Helper Allowance);
- (e) any allowance granted for encouraging the academic research and training pursuits in educational and research institutions;
- (f) any allowance granted to meet the expenditure on the purchase or maintenance of uniform for wear during the performance of the duties of an office or employment of profit (Uniform Allowance).



**Explanation** - For the purpose of clause (a) "allowance granted to meet the cost of travel on transfer" includes any sum paid in connection with the transfer, packing and transportation of personal effects on such transfer.

**Allowances prescribed for the purposes of section 10(14)(ii)**

1. Any Special Compensatory Allowance in the nature of Special Compensatory (Hilly Areas) Allowance or High Altitude Allowance or Uncongenial Climate Allowance or Snow Bound Area Allowance or Avalanche Allowance - ₹ 800 or ₹ 7,000 or ₹ 300 per month depending upon the specified locations.
2. Any Special Compensatory Allowance in the nature of border area allowance or remote locality allowance or difficult area allowance or disturbed area allowance - ₹ 1,300 or ₹ 1,100 or ₹ 1,050 or ₹ 750 or ₹ 300 or ₹ 200 per month depending upon the specified locations.
3. Special Compensatory (Tribal Areas / Schedule Areas / Agency Areas) Allowance - ₹ 200 per month.
4. Any allowance granted to an employee working in any transport system to meet his personal expenditure during his duty performed in the course of running such transport from one place to another, provided that such employee is not in receipt of daily allowance – 70% of such allowance upto a maximum of ₹ 10,000 per month.
5. Children Education Allowance - ₹ 100 per month per child upto a maximum of two children.
6. Any allowance granted to an employee to meet the hostel expenditure on his child ₹ 300 per month per child upto a maximum of two children.
7. Compensatory Field Area Allowance - ₹ 1,300 per month in specified areas.
8. Compensatory Modified Field Area Allowance - ₹ 500 per month in specified areas.
9. Any special allowance in the nature of counter insurgency allowance granted to the members of the armed forces operating in areas away from their permanent locations for a period of more than 30 days - ₹ 1,300 per month.  
Any assessee claiming exemption in respect of allowances mentioned at serial numbers 7, 8 and 9 shall not be entitled to exemption in respect of the allowance referred to at serial number 2.
10. Any transport allowance granted to an employee (other than those referred to in Sl. No. 11 below) to meet his expenditure for the purpose of commuting between the place of his residence and the place of his duty - ₹ 800 per month.
11. Any transport allowance granted to an employee who is blind or orthopaedically handicapped with disability of the lower extremities of the body, to meet his expenditure for commuting between his residence and place of duty - ₹ 1,600 per month.
12. Underground Allowance of ₹ 800 per month would be granted to an employee who is working in uncongenial, unnatural climate in underground coal mines. This is applicable to whole of India.

### Illustration 12

*Mr. Srikant has two sons. He is in receipt of children education allowance of ₹ 150 p.m. for his elder son and ₹ 70 p.m. for his younger son. Both his sons are going to school. He also receives the following allowances:*

*Transport allowance : ₹ 1,000 p.m. (amount spent ₹ 600 p.m.)*

*Tribal area allowance : ₹ 500 p.m.*

*Compute his taxable allowances.*

### Solution

Taxable allowance in the hands of Mr. Srikant is computed as under -

Children Education Allowance:

Elder son	[(₹ 150 – ₹ 100) p.m. × 12 months] = ₹ 600	
Younger son	[(₹ 70 – ₹ 70) p.m. × 12 months] = Nil	₹ 600
Transport allowance	[(₹ 1,000 – ₹ 800) p.m. × 12 months]	₹ 2,400
Tribal area allowance	[(₹ 500 – ₹ 200) p.m. × 12 months]	<u>₹ 3,600</u>
<b>∴ Taxable allowances</b>		<b><u>₹ 6,600</u></b>

### (28) Interest income arising to certain persons [Section 10(15)]

- (i) Income by way of interest, premium on redemption or other payment on notified securities, bonds, annuity certificates or other savings certificates is exempt subject to such conditions and limits as may be specified in the notification. It may be noted that interest on Post Office Savings Bank Account which was so far fully exempt would henceforth be exempt from tax for any assessment year only to the extent of:
  - (1) ₹ 3,500 in case of an individual account.
  - (2) ₹ 7,000 in case of a joint account.
- (ii) Interest on 7% Capital Investment Bonds and 10.1% Relief Bonds, 1993 notified by the Central Government This exemption is available to Individuals and HUFs. Such capital Investment Bonds are not specified on or after 1.6.2002.
- (iii) Interest on NRI bonds, 1988 and NRI Bonds (Second Series), and Resurgent India Bonds, 1998 issued by the SBI arising to (i) Non Resident Indians who own such bonds, (ii) their nominees or survivors, (iii) donees who have received such bonds by way of gift from such non-residents. The interest and principal received in respect of such bonds whether on maturity or otherwise should not be taken out of India. The exemption will continue to apply even after the non-resident, after purchase of such bonds, becomes a resident in any subsequent year. However, the exemption will not apply in the previous year in which such bonds are encashed prior to their maturity. Such bonds shall not be specified on or after 1.06.2002.

- (iv) Interest on securities held by the Issue Department of Central Bank of Ceylon constituted under the Ceylon Monetary Law Act, 1949.
- (v) Interest payable to any bank incorporated in a country outside India and authorised to perform central banking functions in that country on any deposits made by it, with the approval of the RBI, with any scheduled bank.
- (vi) Interest payable to the Nordic Investment Bank, on a loan advanced by it to a project approved by the Central Government in terms of the Memorandum of Understanding entered into by the Central Government with that Bank on 25.11.86.
- (vii) Interest payable to the European Investment Bank, on a loan granted by it in pursuance of the framework agreement for financial co-operation entered into by the Central Government with the Bank on 25.11.1993.
- (viii) Interest payable —
  - (a) by the Government or a local authority on moneys borrowed by it before 1.6.2001 or debts owed by it before 1.6.2001 to sources outside India;
  - (b) by an industrial undertaking in India on moneys borrowed by it before 1.6.2001 under a loan agreement entered into with any such financial institution in a foreign country as may be approved by the Central Government;
  - (c) by an industrial undertaking in India on moneys borrowed or debt incurred by it before 1.6.2001 in a foreign country for the purchase outside India of raw material or capital equipment or components provided that the loan or the debt is approved by the Central Government, to the extent to which such interest does not exceed the amount of the interest calculated at the rate approved by the Government;

“Purchase of capital plant and machinery” includes the purchase of such capital plant and machinery under hire-purchase agreement or a lease agreement with an option to purchase such plant and machinery.

Exemption has also been given for payment of usance interest payable outside India by an undertaking engaged in ship-breaking business, in respect of purchase of a ship from outside India.
  - (d) by IFCI, IDBI, the Export-Import Bank of India and the Industrial Credit and Investment Corporation of India, NHB, SIDBI, on moneys borrowed from sources outside India before 1.6.2001 to the extent to which the interest does not exceed the amount of interest calculated at the rate approved by the Central Government having regard to the terms of the loan and its repayment;
  - (e) by any other financial institution or a banking company established in India on loans raised in foreign countries before 1.6.2001 under approved agreements for the purpose of advancing loans to industrial undertakings in India for importing raw materials or capital plant and machinery or other goods which the Central Government may consider necessary to import in the public interest;
  - (f) by an industrial undertaking in India on moneys borrowed by it in foreign currency

from foreign sources under a loan agreement approved by the Central Government before 1.6.2001 having regard to the need for industrial development in India will be exempt from income-tax, to the extent to which such interest does not exceed the amount of interest calculated at the rates approved by the Central Government in this behalf, having regard to the terms of the loan and its repayment.

- (g) by a scheduled bank on deposits in foreign currency held by a non-resident or a person who is not ordinarily resident, where the acceptance of such deposits by the bank is approved by the RBI. It may be noted that for the purpose of exemption under this clause, a scheduled bank does not include a co-operative bank.
- (h) by an Indian public limited company, being a company eligible for deduction under section 36(1)(viii), mainly engaged in providing long-term finance for construction or purchase of residential houses in India on loans raised in foreign countries under a loan agreement approved by the Central Government before 1.6.2003
- (i) by public sector companies on certain specified bonds and debentures subject to the conditions which the Central Government may specify by notification, including the condition that the holder of such bonds or debentures registers his name and holding with that company;

Accordingly, the Central Government has specified tax free bonds issued by India Infrastructure Company Ltd. and tax free, secured, redeemable, non-convertible Bonds of the Indian Railway Finance Corporation Ltd. (IRFCL), National Highways Authority of India (NHAI), Rural Electrification Corporation Ltd. (RECL), Housing and Urban Development Corporation Ltd. (HUDCL), Power Finance Corporation (PFC), Jawaharlal Nehru Port Trust, Dredging Corporation of India Limited, Ennore Port Limited and The Indian Renewable Energy Development Agency Limited, the interest from which would be exempt under this section.

- (j) by Government of India on deposit made by an employee of the Central or State Government or a public sector company in accordance with the scheme as may be notified of the moneys due to him on account of his retirement while on superannuation or otherwise. It is significant that this scheme is not applicable to non-Government employees.

The term 'industrial undertaking' means any undertaking which is engaged in:

- (i) the manufacture or processing of goods; or
- (ii) the manufacture of computer software or recording of programmes on any disc, tape, perforated media or other information device; or
- (iii) the business of generation or generation and distribution of electricity or any other form of power; or
- (iv) the business of providing telecommunication services; or
- (v) mining; or
- (vi) construction of ships, or

(vii) the business of ship-breaking; or

(viii) the operation of ships or aircrafts or construction or operation of rail systems.

For the purposes of the clause, "interest" shall not include interest paid on delayed payment of loan or default if which is more than 2% p.a. over the rate of interest payable in terms of such loan. Interest would include hedging transaction charges on account of currency fluctuation.

(ix) Bhopal Gas Victims - Section 10(15)(v) provides exemption in respect of interest on securities held by the Welfare Commissioner, Bhopal Gas Victims, Bhopal, in the Reserve Bank's Account No. SL/DH 048. Recently, in terms of an order of the Supreme Court to finance the construction of a hospital at Bhopal to serve the victims of the gas leak, the shares of the Union Carbide Indian Ltd., have been sold. The sale consideration reserved for construction has been deposited with SBI, New Delhi. The interest on the aforesaid deposit and similar deposits which may be made in future needs to be provided income tax exemption. The scope of the above exemption has been extended to interest on deposits for the benefit of the victims of the Bhopal Gas Leak disaster. Such deposits can be held in such account with the RBI or with a public sector bank as the Central Government may notify in the Official Gazette. Such notification may have prospective or retrospective effect. However, in no case it can be effective from a period earlier than 1-4-1994.

(x) Interest on Gold Deposit Bond issued under the Gold Deposit Scheme, 1999 notified by the Central Government.

(xi) Interest on bonds, issued by –

(a) a local authority; or

(b) a State Pooled Finance Entity

and specified by the Central Government by notification in the Official Gazette.

"State Pooled Finance Entity" means such entity which is set up in accordance with the guidelines for the Pooled Finance Development Scheme notified by the Central Government in the Ministry of Urban Development.

Accordingly, the Central Government has specified the "Tax-free Pooled Finance Development Bonds" under Pooled Finance Development Fund Scheme of Government of India, interest from which would be exempt under section 10(15).

(xii) interest income received by a non-resident/not-ordinarily resident in India from a deposit made on or after 1.4.2005 in an Offshore Banking Unit referred to in section 2(u) of the SEZ Act, 2005 i.e. a branch of a bank located in a SEZ and which has obtained permission under section 23(1)(a) of the Banking Regulation Act, 1949.

**(29) Payments for acquisition of aircraft [Section 10(15A)]** – Any payment made by an Indian company engaged in the business of operation of aircraft to acquire an aircraft on lease from the government of a foreign State or a foreign enterprise under an agreement not being

an agreement entered into between 1-4-1997 and 31-3-1999, and approved by the Central Government in this behalf will be exempt. For the purpose of this clause 'foreign enterprise' means a person who is a non-resident.

This exemption has been withdrawn in respect of all such agreements entered into on or after 1st April, 2007.

The exemption for lease payments shall continue with regard to agreements entered into before 1.4.2007. Consequently, the benefit of exemption from tax, on the tax paid will be available in respect of lease payments made in pursuance of agreements entered into on or after 1.4.2007. The effect of these amendments is that up to 31.3.2007, the consideration for lease itself is exempt from tax. With effect from 1.4.2007, the consideration for lease is taxable and if the Indian company who makes payment of such consideration undertakes to bear the tax on behalf of the lessor, then such tax shall not be considered as income and further taxed. Such tax paid by the Indian company would be exempt from further tax. This is provided in clause (6BB) of section 10.

**(30) Educational scholarships [Section 10(16)]** - The value of scholarship granted to meet the cost of education would be exempt from tax in the hands of the recipient irrespective of the amount or source of scholarship.

**(31) Payments to MPs & MLAs [Section 10(17)]** - The following incomes of Members of Parliament or State Legislatures will be exempt:

- (i) Daily allowance received by any Member of Parliament or of State Legislatures or any Committee thereof.
- (ii) In the case of a Member of Parliament or of any Committee thereof, any allowance received under Members of Parliament (Constituency Allowance) Rules, 1986; and
- (iii) Any constituency allowance received by any person by reason of his membership of any State Legislature under any Act or rules made by that State Legislature.

**(32) Awards for literary, scientific and artistic works and other awards by the Government [Section 10(17A)]** - Any award instituted in the public interest by the Central/State Government or any body approved by the Central Government and a reward by Central/State Government for such purposes as may be approved by the Central Government in public interest, will enjoy exemption under this clause.

**(33) Pension received by recipient of gallantry awards [Section 10(18)]** - Any income by way of pension received by an individual who has been awarded "Param Vir Chakra" or "Maha Vir Chakra" or "Vir Chakra" or such other gallantry award as the Central Government may, by notification in the Official Gazette, specify in this behalf.

In case of the death of the awardee, any income by way of family pension received by any member of the family of the individual shall also be exempt under this clause. The expression "family" shall have the meaning assigned to it in the Explanation to clause (5) of the said section.

**(34) Family pension received by widow/children/nominated heirs of members of armed forces [Section 10(19)]** – Exemption is available in respect of family pension received by the widow or children or nominated heirs, of a member of the armed forces (including para-military forces) of the Union, where the death of such member has occurred in the course of operational duties, in specified circumstances and circumstances.

**(35) Annual value of palaces of former rulers [Section 10(19A)]** - The annual value of any one palace in the occupation of former Rulers would be excluded from their total income provided such annual value was exempt from income-tax before the de-recognition of Rulers of Indian States and abolition of their privy purses.

**(36) Income of local authorities [Section 10(20)]** – (i) All income arising to a local authority, other than from trade or business carried on by it which accrues or arises from the supply of commodity or service under its jurisdictional area is excludible from its total income.

(ii) Exemption is available to income derived by a local authority from the supply of water or electricity even outside its juridical area.

(iii) For the purposes of this clause, “local authority” means the following:

- (1) Panchayat
- (2) Municipality
- (3) Municipal Committee and District Board legally entitled to, or entrusted by the Government with the control or management of a Municipal or local Fund
- (4) Cantonment Board

**(37) Income of research associations approved under section 35(1)(ii) [Section 10(21)]** - This clause also provides for exemption in respect of any income of research associations which are approved under section 35(1)(ii)/(iii). This exemption has however, been made subject to the following conditions:

(i) It should apply its income or accumulate for application wholly and exclusively to its objects and provisions of section 11(2) and (3) would also apply in relation to such accumulation.

(ii) The association should invest or deposit its funds in the forms or modes specified in section 11(5). This condition would however not apply to -

- (1) any assets held by the research association where such assets form part of the corpus of the fund of the association as on 1-6-1993;
- (2) any debentures of a company acquired by the association before 1-3-1983;
- (3) any bonus shares coming as an accretion to the corpus mentioned above;
- (4) voluntary contributions in the form of jewellery, furniture or any article notified.

(iii) The exemption will not apply to income of such association which are in the nature of profits and gains of business unless the business is incidental to the attainment of its

objectives and separate books of account are maintained in respect of such business.

- (iv) However, approval once granted may be withdrawn if at any time the Government is satisfied that –
  - (1) the research association has not applied its income in accordance with sections 11(2) and (3);
  - (2) the research association has not invested or deposited its funds in accordance with section 11(5).

Such withdrawal shall be made after giving reasonable opportunity to the assessee. A copy of the order shall be sent to the Assessing Officer as well as the assessee.

**(38) Income of news agency [Section 10(22B)]** – (i) This clause provides income-tax exemption on any income of such news agency set up in India solely for collection and distribution of news as specified by the Central Government.

- (ii) However, in order to get this exemption, the news agency should:
  - (a) apply its income or accumulate it for application solely for collection and distribution of news.
  - (b) It should not also distribute its income in any manner to its members.
- (iii) Any notification issued by the Central Government under this clause will have effect for 3 assessment years. It may include an assessment year or years commencing before the date of notification.
- (iv) However, once the notification has been issued, the notification may be rescinded approval if at any time the Government is satisfied that the news agency has not applied or accumulated or distributed its income in accordance with the provisions of this section.
- (v) The notification may be rescinded after giving reasonable opportunity to the assessee. A copy of the order shall be sent to the Assessing Officer as well as the assessee.

**(39) Income of professional associations [Section 10(23A)]** – (i) Associations or institutions of the following classes approved by the Government and applying their income or accumulating it solely to their objects shall be exempt from tax on certain items of their income. The association or institution must:

- (a) be established in India;
- (b) have as its object the control, supervision, regulation or encouragement of the profession of law, medicine, accountancy, engineering or architecture, or any other profession specified by the Central Government.
- (ii) All income arising to such an association, except the following categories of income, are exempt from inclusion in income:
  - (a) income under the head 'interest on securities';
  - (b) income under the head 'income from house property';
  - (c) income received for rendering any specific service; and



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- (d) income by way of interest or dividends derived from its investments.
- (iii) However, approval once granted may be withdrawn if at any time the Government is satisfied that –
  - (1) the association or institution has not applied or accumulated its income in accordance with the provisions of the section;
  - (2) the activities of the association or institution are not being carried out in accordance with the conditions imposed on the basis of which the approval was granted.
- (iv) Such withdrawal shall be made after giving reasonable opportunity to the assessee. A copy of the order shall be sent to the Assessing Officer as well as the assessee.

**(40) Income of institutions established by armed forces [Section 10(23AA)]** - Any income received by any person on behalf of any regimental fund or non-public fund established by the armed forces of the Union for the welfare of the past and present members of such forces or their dependents is exempt from tax.

Students may note that donations to such institutions will qualify for deduction under section 80G.

**(41) Income of Funds established for welfare of employees of which such employees are members [Section 10(23AAA)]** - A number of funds have been established for the welfare of employees or their dependents in which such employees themselves are members. These funds are utilised to provide cash benefits to a member on his superannuation, or in the event of his illness or illness of any member of his family, or to the dependents of a member on his death.

**Example :** XYZ Ltd. has an employee welfare fund. Employees, who are members of the fund, contribute a portion of their salary to the fund. The company makes an annual contribution equal to the employees' contribution. The funds thus made available are utilised by the fund to provide benefits to the members or their dependents in case of illness etc. The surplus fund may be invested in bonds, Government securities or deposited with banks. Essentially, these funds are in the nature of mutual benefit funds. Hence, their income does not qualify for exemption under section 10(23C)(iv). Since they are not charitable institutions they cannot also claim exemption under section 11 in respect of their income. They are now entitled for exemption under section 10(23AAA).

Accordingly, in exercise of the powers conferred by section 10(23AAA), the CBDT has notified the following purposes –

- (1) cash benefits to a member of the fund -
  - (a) on superannuation, or
  - (b) in the event of his illness or illness of his spouse or dependent children, or
  - (c) to meet the cost of education of his dependent children or
- (2) cash benefits to the dependents of a member of the fund in the event of the death of such member.

- (3) cash benefits to a member of the fund to meet the cost of annual medical tests or medical checkups of a member, his spouse and dependent children as one of the purposes of the fund.

The exemption will be available only if the following conditions are fulfilled:

- (i) the fund should have been established for the welfare of employees or their dependents and for such purposes as may be notified by the Board;
- (ii) such employees should be the members of the fund;
- (iii) the fund should apply its income, or accumulate it for application, wholly and exclusively to the objects for which it is established;
- (iv) the fund shall invest its fund and contributions made by the employees and other sums received by it in any one mode specified under section 11(5);
- (v) the fund should be approved by *the Principal Commissioner or* Commissioner in accordance with the prescribed rules. The approval shall have effect for such assessment year or years not exceeding three assessment years as may be specified in the order of approval.

**Note:**

- 1. There are no conditions regarding accumulation towards the object of the fund.
- 2. There is no requirement of application of any minimum percentage of the income towards the object of the fund.
- 3. No time limit has been prescribed within which the fund must exercise the option of accumulation.
- 4. Any contribution made by an employer to this approved welfare fund would also not be allowed as a deduction.

**(42) Income of Fund set up by Life Insurance Corporation under pension scheme [Section 10(23AAB)]** - Any income of a fund set up by the LIC of India or any other insurer under a pension scheme to which contribution is made by any person for receiving pensions from such fund. Such scheme should be approved by the Controller of Insurance or the IRDA.

**(43) Income of institution established for development of Khadi and Village Industries [Section 10(23B)]** – (i) The exemption will be available to institutions constituted as public charitable trusts or registered under the Societies Registration Act, 1860 or under any law corresponding to that Act in force in any part of India existing solely for development of khadi and village industries.

- (ii) Income derived by such institutions from the production, sale or marketing of Khadi products or village industries would be exempt from income-tax.
- (iii) The conditions for availing exemption are:
  - (1) The institution has to apply its income or accumulate it for application, solely for the development of village industries.

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- (2) They should be approved by the Khadi and Village Industries Commission.
- (3) Such approval is granted for a period of 3 years at a time.
- (iv) However, approval once granted may be withdrawn if at any time the Government is satisfied that –
  - (1) the institution has not applied or accumulated its income in accordance with the provisions of the section;
  - (2) the activities of the institution are not being carried out in accordance with the conditions imposed on the basis of which the approval was granted.
- (v) Such withdrawal shall be made after giving reasonable opportunity to the assessee. A copy of the order shall be sent to the Assessing Officer as well as the assessee.
- (44) Income of authorities set up under State or Provincial Act for promotion of Khadi and Village Industries [Section 10(23BB)]** - Income derived by authorities similar to Khadi and Village Industries Commission, set up under any State or Provincial Act, for the development of Khadi or Village industries in the state is exempt from tax.
- (45) Income of authorities set up to administer religious or charitable trusts [Section 10(23BBA)]** – (i) Income of bodies or authorities established, constituted or appointed under any enactment for the administration of public, religious or charitable trust or endowments (including maths, temples, gurudwaras, wakfs, churches, synagogues, agiaries or other places of public religious worship) or societies for religious or charitable purpose is exempt from tax.  
(ii) However, exemption will apply to the income of the administrative bodies or authorities but shall not apply to the income of any such trust, endowment or society mentioned above.
- (46) Income of European Economic Community (EEC) [Section 10(23BBB)]** - This clause provides exemption on any income of the EEC derived in India by way of interest, dividends or capital gains from investments made out of its funds under a scheme notified by the Government.
- (47) Income derived by the SAARC Fund for Regional Projects [Section 10(23BBC)]** - Any income derived by the SAARC Fund for Regional Projects which was set up by Colombo Declaration shall be exempt.
- (48) Income of the IRDA [Section 10(23BBE)]** - Any income of the IRDA established under section 3(1) of the IRDA Act, 1999 will be exempt.
- (49) Exemption of income of Central Electricity Regulatory Commission [Section 10(23BBG)]** - This section provides exemption to any income of Central Electricity Regulatory Commission constituted under sub-section (1) of Section 76 of the Electricity Act, 2003.
- (50) Exemption of income of Prasar Bharati (Broadcasting Corporation of India) [Section 10(23BBH)]** - Any income of the Prasar Bharati (Broadcasting Corporation of India) established under section 3(1) of the Prasar Bharati (Broadcasting Corporation of India) Act, 1990 is exempt under this section.

(51) **Income of certain funds or institutions [Section 10(23C)]** - An exemption is available in respect of any income received by any person on behalf of the following entities:

- (i) the Prime Minister's National Relief Fund [Sub-clause (i)];
- (ii) the Prime Minister's Fund (Promotion of Folk Art) [Sub-clause (ii)];
- (iii) the Prime Minister's Aid to Students Fund [Sub-clause (iii)];
- (iv) the National Foundation for Communal Harmony [Sub-clause (iiia)];
- (v) any other Fund or Institution for charitable purposes approved by the prescribed authority having regard to the objects of the fund or institution and its importance throughout India or throughout any State or States [Sub-clause (iv)];
- (vi) any trust (including any other legal obligation) or institution wholly for public religious or public religious and charitable purposes approved by the prescribed authority [Sub-clause (v)];
- (vii) any university or other educational institution wholly or ***substantially financed by the Government*** which exists solely for educational purposes and not for profit [Sub-clause (iiia)];
- (viii) any hospital or other institution wholly or ***substantially financed by the Government***, which exists solely for philanthropic purposes and not for profit and which exists for the reception and treatment of persons suffering from illness or mental defectiveness or treatment of convalescing persons or persons requiring medical attention [Sub-clause (iiia)];

*If the government grant to a university or other educational institution, hospital or other institution during the relevant previous year exceeds a percentage (to be prescribed) of the total receipts (including any voluntary contributions), of such university or other educational institution, hospital or other institution, as the case may be, then, such university or other educational institution, hospital or other institution shall be considered as being **substantially financed by the Government** for that previous year.*

- (ix) any university or other educational institution existing solely for educational purposes and not for profit and its aggregate annual receipts do not exceed ₹ 1 crore [Sub-clause (iiia)];
- (x) any hospital or other institution as described in (ix) above if its aggregate annual receipts do not exceed the prescribed limit of ₹ 1 crore [Sub-clause (iiia)];
- (xi) any other university or educational institutions approved by prescribed authority [Sub-clause (vi)];
- (xii) any other hospital, etc. approved by prescribed authority [Sub-clause (via)].

**Note:**

1. The application form for such exemption will have to be made in the prescribed form and manner.

2. The prescribed authority, is empowered to call for such documents or information as it considers necessary in order to satisfy itself about the genuineness of the activities of the fund or trust or institution or any university or other educational institution or any hospital or other medical institution, before approving the same under section 10(23C)(iv), (v), (vi) or (via). Such documents may include audited annual accounts. The prescribed authority may also make such inquiries as it may deem necessary for this purpose.
3. Exemption under section 10(23C)(iv)/(v) would apply only if the funds are invested or deposited for any period during the relevant previous year otherwise in the modes specified in section 11(5). This requirement will not however apply where the investment is maintained in the form of jewellery, furniture or any other article notified by the Board. For this purpose, the fund or trust or institution must fulfill the following conditions:
  - (a) It should apply its income or accumulate it for application wholly and exclusively to the objects for which it is established,
  - (b) In case where more than 15% of its income is accumulated on or after 1.4.2002, the period of accumulation of the amount exceeding 15% of its income shall be maximum 5 years.
  - (c) It should invest or deposit the following kinds of funds:
    - any assets which form part of the corpus of the fund, trust or institution as on 1.6.1973;
    - any equity shares of a public company held by any University or other educational institution or any hospital or other medical institution where such assets form part of its corpus as on 1.6.1998;
    - any debentures, issued by or on behalf of any company or corporation, acquired by the fund, trust or institution, etc. before 1.3.1983;
    - any bonus shares allotted to the fund, trust or institution, etc. in respect of the shares mentioned above forming part of the corpus of such fund, etc.
    - any voluntary contributions received and maintained in the form of jewellery, furniture or other article as the Board may specify for any period during the previous year. However, such assets should not be in the forms or modes of investment laid down in section 11(5).
4. Investments or deposits made before 1.4.1989 in any mode or form not specified in Section 11(5) should be liquidated and invested in such modes, by 30.3.1993.
5. In case of (xi) and (xii) above, if any funds of such institution or hospital are invested before 1.6.1998 in any mode other than that specified in section 11(5), the exemption to such an institution shall not be denied if such funds do not continue to be so invested or deposited after 30.3.2001.
6. Exemption under sub-clause (iv) or (v) (vi) or (via) would be available only if the funds are invested in mode specified in section 11(5), within 1 year from the end of the

previous year in which the asset is acquired or 31.3.1992, whichever is earlier.

7. Exemption under section 10(23C)(iv) or (v) or (vi) or (via) would not apply to profits and gains of business in all cases. However, where the business is incidental to the attainment of its objectives and separate books of account are maintained in respect of the business, the exemption would apply to such business profits also.
8. Notification issued under sub-clauses (iv) and (v) before 13.7.2006, being the date on which the Taxation Laws (Amendment) Act, 2006 received the assent of the President, shall have effect for a maximum 3 assessment years at any one time. Any notification issued by the Central Government [under sub-clauses (iv) or (v)] on or after 13.7.2006 will be valid until withdrawn and there will be no requirement on the part of the assessee to seek renewal of the same after 3 years.
9. In order to expedite disposal of such applications, it has now been provided that where such an application is made on or after 13.7.2006, every notification under sub-clause (iv) or sub-clause (v) shall be issued or approval under sub-clause (vi) or sub-clause (via) shall be granted or an order rejecting the application shall be passed within the period of 12 months from the end of the month in which such application was received.
10. If the total income of any entity referred to in sub-clauses (iv), (v), (vi) and (via) of section 10(23C), without giving effect to the provisions of the said sub-clauses, exceeds the basic exemption limit in any previous year, it shall –
  - (1) get its accounts audited in respect of that year by a chartered accountant; and
  - (2) furnish such audit report along with the return of income for the relevant assessment year. The report must be in the prescribed form, duly signed and verified by the accountant, and must contain such particulars as may be prescribed.
11. In case of donations received between 26.1.2001 and 30.9.2001 for the purpose of providing relief to victims of the Gujarat earthquake, any amount unutilized or mis-utilized and not transferred to the Prime Minister's National Relief Fund on or before 31.3.2004 shall be deemed to be the income of the previous year, chargeable to tax. Further, exemption will not be available if such fund/institution does not render accounts of income and expenditure to authority prescribed under section 80G(5C)(v) as prescribed.
12. Where the fund / trust / institution / university / hospital etc. does not apply its income during the year of receipt and accumulates it, and subsequently makes a payment or credit out of such accumulated income, to any institution or trust registered u/s 12AA or to any fund / trust / institution / university / hospital, such payment or credit shall not be considered to be an application of income for its specified objectives.
13. The Central Government, or prescribed authority shall have the power to withdraw the approval or rescind the notification if:
  - (i) such fund/institution/university/hospital etc. has not applied its income or invested/deposited its funds in accordance with the provisions. or

- (ii) the activities of such fund, etc are not genuine; or
- (iii) such activities are not being carried out in accordance with the conditions based upon which it was notified or approved.

However, the approval or notification can be withdrawn or rescinded only after issuing a show cause notice and giving reasonable opportunity to such fund, etc. of being heard. After withdrawing the approval or rescinding the notification, a copy of the order is to be forwarded to the concerned fund/institution, etc. as well as to the Assessing Officer.

14. The time limit for making an application for grant of exemption or continuation thereof under section 10(23C) by a fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in sub-clauses (iv)/(v)/(vi)/(via) of section 10(23C) has been specified in respect of such applications made on or after 1.6.2006. Such applications have to be filed on or before 30<sup>th</sup> September of the succeeding financial year.

For example, if an educational institution seeks exemption under clause (vi) for P.Y.2014-15 (i.e. A.Y.2015-16), it has to make an application for grant of exemption by 30.9.2015.

15. However, any anonymous donation referred to in section 115BBC on which tax is payable in accordance with the provisions of the said section shall be included in the total income.
16. It has also been provided that all pending applications in respect of which no notification has been issued under the said sub-clause (iv) or (v) before 1st June, 2007, shall stand transferred on that day to the prescribed authority and the prescribed authority may proceed with such applications from the stage at which they were on that day.
17. If the purpose of a trust or institution referred to in sub clauses (iv)/(v) of section 10(23C) does not remain charitable in a previous year on account of the commercial receipts exceeding the specified threshold of ₹ 25 lakhs, then, such trust or institution would not be entitled to get benefit of exemption in respect of its income for that previous year in which the commercial receipts exceed the specified threshold. The denial of exemption would be compulsory by operation of law and would not be dependent on any approval being withdrawn or registration being cancelled or a notification being rescinded.

Such trust and institution cannot get benefit of tax exemption in the year in which its receipts from commercial activities exceed the specified threshold of ₹ 25 lakhs, whether or not the registration or approval granted or notification issued is cancelled, withdrawn or rescinded in respect of such trust or institution.

18. *Entities which have been approved or notified for claiming benefit of exemption under section 10(23C) would not be entitled to claim any benefit of exemption under any other provision of section 10 (except exemption under section 10(1) in respect of agricultural income). This is to ensure that once a trust or institution voluntarily opts for the special dispensation under this section, it should be governed by these provisions and should not be allowed the flexibility of being*

*governed by the general provisions of section 10. Allowing such flexibility may have adverse effects on the objective for which this section was enacted.*

19. *Income for the purposes of application under section 10(23C) shall be determined without allowing any deduction or allowance for depreciation or otherwise, where the cost of acquisition of the asset has been claimed as application of income under section 10(23C) in the same previous year or any other previous year.*

(52) **Income of Mutual Fund [Section 10(23D)]** – (i) The income of a Mutual Fund set up by a public sector bank / public financial institution / SEBI / RBI subject to certain conditions is exempt.

(ii) "Public sector bank" means SBI or any nationalised bank or a bank included in the category "other public sector banks" by the RBI, for example, IDBI Bank.

**Note:** 1. The income of a mutual fund registered under the SEBI will be exempt without any conditions laid down by the Central Government

3. In the case of other mutual funds, the conditions will be applicable.

(53) **Exemption of any income of a securitization trust from the activity of securitization [Section 10(23DA)]**

Section 10(35A)	Exemption of the distributed income referred to in section 115TA (received from a securitization trust) in the hands of the recipient-investor consequent to levy of additional income-tax on such distributed income in the hands of the securitization trust.
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- (i) Securitization trusts are special purpose entities set up in the form of trust to undertake securitization activities.
- (ii) For the purpose of the exemption and taxability provisions under the Income-tax Act, 1961, a "securitization trust" means a trust which is a special purpose distinct entity or special purpose vehicle, the details of which are tabulated hereunder, which fulfills the prescribed conditions –

	Form of trust	Regulation/ Guidelines	Definition under the respective Regulation/Guidelines
(1)	Special purpose distinct entity	SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008.	Special purpose distinct entity means a trust which acquires debt or receivables out of funds mobilized by it by issuance of securitised debt instruments through one or more schemes, and includes any trust set up by the National Housing Bank or by the NABARD.  For this purpose, " <i>securitised debt instrument</i> " means any certificate or instrument, by whatever name called, issued to an investor by any issuer being a special purpose distinct entity which



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			possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable including mortgage debt, as the case may be;
(2)	Special purpose vehicle (SPV)	The guidelines on securitization of standard assets issued by RBI.	SPV means any company, trust, or other entity constituted or established for a specific purpose – (a) activities of which are limited to those for accomplishing the purpose of the company, trust or other entity as the case may be; and (b) which is structured in a manner intended to isolate the corporation, trust or entity as the case may be, from the credit risk of an originator to make it bankruptcy remote.

- (iv) A special taxation regime was introduced by the Finance Act, 2013 in respect of taxation of income of securitisation entities, set up as a trust, from the activity of securitisation.

The significant provisions of the special regime are :-

- (1) In case of securitisation vehicles which are set up as a trust and the activities of which are regulated by either SEBI or RBI, the income from the activity of securitisation of such trusts will be exempt from taxation. Section 10(23DA) exempts any income of a securitization trust from the activity of securitization with effect from A.Y.2014-15.
- (2) Chapter XII-EA<sup>1</sup>, comprising of sections 115TA, 115TB and 115TC, levies additional income-tax on securitization trusts in respect of income distributed to its investors.
- (3) Consequent to the levy of distribution tax, the distributed income referred to in section 115TA received from a securitization trust will be exempt from tax in the hands of the recipient-investor. [Section 10(35A)].

**(54) Income of Investor Protection Funds [Section 10(23EA)]** – (i) Clause (23EA) excludes any income by way of contributions received from recognized stock exchanges and the members thereof, from the total income of an Investor Protection Fund set up by recognised stock exchanges in India, either jointly or separately, and notified by the Central Government in this behalf.

- (ii) Where any amount standing to the credit of the Fund and not charged to income-tax

<sup>1</sup> Chapter XII-EA is not covered within the syllabus of Intermediate (IPC) Course. Therefore, the provisions of section 115TA, 115TB and 115TC have not been discussed here. These provisions will be dealt with in detail at the Final level.

during any previous year is shared, either wholly or in part, with a recognised stock exchange, the whole of the amount so shared shall be deemed to be the income of the previous year in which such amount is so shared and shall accordingly be chargeable to income-tax.

**(55) Exemption of specified income of Investor Protection Fund set up by commodity exchanges [Section 10(23EC)]** - (i) This clause exempts income, by way of contributions received from commodity exchanges and the members thereof, of such Investor Protection Fund set up by commodity exchanges in India, either jointly or separately, as the Central Government may, by notification in the Official Gazette, specify in this behalf.

(ii) Where any amount standing to the credit of the said Fund and not charged to income-tax during any previous year is shared, either wholly or in part, with a commodity exchange, the entire amount so shared shall be deemed to be the income of the previous year in which the amount is so shared and shall accordingly be chargeable to income-tax.

(iii) A "commodity exchange" means a "registered association" as defined in clause section 2(jj) of the Forward Contracts (Regulation) Act, 1952. i.e. an association to which for the time being a certificate of registration has been granted by the Forward Markets Commission under section 14B of that Act.

**(56) Exemption of income of Investor Protection Fund set up by depositories [Section 10(23ED)]**

(i) Consequent to amendment in the SEBI (Depositories and Participants) Regulations, 1996, in the year 2012, there is a compulsory requirement for depositories to set up an Investor Protection Fund.

(ii) "Depository" means a company formed and registered under the Companies Act, 1956 and which has been granted a certificate of registration under section 12(1A) of the SEBI Act, 1992

(iii) Under section 10(23EA), income by way of contributions from a recognised stock exchange received by a Investor Protection Fund set up by the recognised stock exchange is exempt from taxation.

(iv) In line with section 10(23EA), the Finance Act, 2013 has inserted section 10(23ED) to provide that any income, by way of contribution from a depository, of such Investor Protection Fund set up by a depository in accordance with the regulations made under the SEBI Act, 1992 and the Depositories Act, 1996, will not be included while computing the total income of such investor protection fund. The Central Government, would, by way of notification in the Official Gazette, specify such investor protection funds set up by depositories in accordance with the SEBI and depositories regulations.

(v) However, where any amount standing to the credit of the fund and not charged to income-tax during any previous year is shared wholly or partly with a depository, the amount so shared shall be deemed to be the income of the previous year in which such amount is shared. Accordingly, such amount would be chargeable to income-tax.

**(57) Income of Venture Capital Company / Fund [Section 10(23FB)]** - This clause exempts any income of a venture capital company (VCC) or venture capital fund (VCF) set up to raise funds for investment in a venture capital undertaking (VCU). Further, as per section 115U, income accruing or arising or received by a person out of investment made in a VCC or VCF shall be taxable in the like manner as if the person had made direct investment in the VCU.

In effect, under sections 10(23FB) and 115U, a tax pass through status (i.e. income is taxable in the hands of investors instead of VCF/VCC) is available to such funds which satisfy the investment and other conditions as are provided in SEBI (Venture Capital Funds) Regulations, 1996. Further, these sections provide a "pass through status" only in respect of income which arises to the fund from investment in VCU, being a company which satisfies the conditions provided in SEBI (Venture Capital Fund) Regulations, 1996.

The SEBI (Alternative Investment Funds) Regulations, 2012 (AIF regulations) have replaced the SEBI (Venture Capital Fund) Regulations, 1996 (VCF regulations) from 21st May, 2012. The AIF Regulations now regulate all privately pooled investment vehicles which collect funds from investors for investments in accordance with a predefined investment policy for the benefit of its investors. AIF can be a fund established or incorporated in the form of a trust, company, LLP or body corporate. The AIF Regulations cover a much wider ambit of funds and categorize them into broadly three categories:

Category I AIF comprises of funds which invest in start-up or early stage ventures or social ventures or SMEs or infrastructure or other sectors or areas which the government or regulators consider as socially or economically desirable.

Category I AIF presently has 4 sub-categories, namely, venture capital funds, SME Funds, social venture funds and infrastructure funds. Investment norms have been prescribed for each of the sub-categories to ensure that the fund allocates substantial majority of its capital to the target focus. The stated intent of Category I AIF is to cover AIFs that are generally perceived to have positive spillover effects on economy and for which the SEBI/ Government/ other regulators might consider providing incentives or concessions. The Explanation to Regulation 3(4)(a) of AIF Regulations which clarified this aspect also clarified that such funds which are formed as trusts or companies shall be construed as VCF/VCC as specified under section 10(23FB) of the Income-tax Act, 1961.

Category II AIF is a residual category and covers AIFs for which no specific incentives or concessions are given by the Government/other regulators. Category II AIF will cover classic private equity funds and debt funds. Such funds do not undertake leverage or borrowing other than to meet day-to-day operational requirements.

Category III AIFs are AIFs which employ diverse or complex trading strategies and may employ leverage including through investment in listed or unlisted derivatives. Category III AIF will cover hedge funds or funds which trade with a view to make short term returns or such other funds which are open ended. As in the case of Category II AIFs, no specific incentives or concessions are given by the Government/other regulators.

Under the Income-tax Act, 1961, "pass through status" has been granted only to the Venture Capital Fund, being a sub-category of Category I AIFs, with a corresponding direct tax charge on the investors. The benefit is available to only such AIFs which are established as a trust or a company. Further, the Income-tax Act, 1961 requires compliance of three conditions by such AIFs, in order to be covered within the ambit of exemption under section 10(23FB), namely:

- (1) The units of a trust set up as AIF and shares of a company set up as AIF should not be listed on a recognised stock exchange.
- (2) The AIF (established as a company) should not have invested in a VCU, in which its director or a substantial shareholder (being a beneficial owner of equity shares exceeding 10% of its equity share capital) holds, either individually or collectively, equity shares in excess of 15% of the paid-up equity share capital of such venture capital undertaking.

The AIF (established as a trust) should not have invested in any VCU in which its trustee or the settlor holds, either individually or collectively, equity shares in excess of 15% of the paid-up equity share capital of such VCU.

- (3) The AIF should have invested not less than two-thirds of its investible funds in unlisted equity shares/ equity linked instruments of VCU.

**The tax implications under the Income-tax Act, 1961 are as follows -**

(i) VCCs/VCFs registered prior to 21st May 2012 under SEBI (VCF) Regulations, 1996 (VCF regulations), will continue to be eligible for "pass through status" under section 10(23FB) read with section 115U.

(ii) The impact on AIFs registered on or after 21st May, 2012 under AIF Regulations are summarized as follows :-

Category	Sub-categories	Tax status in the event AIF is registered on or after 21 May 2012
I	VCF, being trust & VCC	Would qualify as VCC/VCF under section 10(23FB) but, subject to compliance of three conditions viz., (1) Shares of company/units of trust set up as an AIF are not listed on a recognized stock exchange. (2) Has invested not less than 2/3 <sup>rd</sup> of its investible funds in unlisted equity shares/equity linked instruments of VCUs (3) Has not invested in associate VCUs.
I	SME Fund Social Venture Fund Infrastructure Fund	Will not qualify as VCC/VCF under section 10(23FB) and consequently will not be eligible for "pass through status" despite being identified as socially desirable having positive spillover effects on the economy and eligible for other concessions from Government/SEBI. Will be governed by normal provisions of taxation as applicable to relevant nature of entity.

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Category	Sub-categories	Tax status in the event AIF is registered on or after 21 May 2012
II	Generally includes private equity and debt funds	Will not qualify as VCC/VCF under section 10(23FB)
III	Generally includes hedge funds	

**Note** - Venture Capital Undertaking (VCU), for the purpose of this section, would include –

VCU as defined in clause (n) of Regulation 2 of VCF Regulations	VCU as defined in clause (aa) of Regulation 2(1) of the AIF Regulations
<p>A domestic company—</p> <p>(i) whose shares are not listed on a recognized stock exchange in India;</p> <p>(ii) which is engaged in the business for providing services, production or manufacture of article or things or does not include such activities or sectors which are specified in the negative list by the Board with the approval of the Central Government by notification in the Official Gazette in this behalf.</p>	<p>A domestic company -</p> <p>(i) which is not listed on a recognised stock exchange in India at the time of making investment; and</p> <p>(ii) which is engaged in the business for providing services, production or manufacture of article or things and does not include following activities or sectors:</p> <ol style="list-style-type: none"> <li>(1) non-banking financial companies (NBFCs);</li> <li>(2) gold financing;</li> <li>(3) activities not permitted under industrial policy of Government of India;</li> <li>(4) any other activity which may be specified by the Board in consultation with Government of India from time to time;</li> </ol>

**(58) Income of trade unions [Section 10(24)]** - Any income under the heads “income from house property” and “income from other sources” of a registered trade union, within the meaning of the Trade Unions Act, 1926, formed primarily for the purpose of regulating the relations between workmen and the employers or between workmen and workmen will be exempt. Further, this exemption is also available in respect of an association of such registered unions.

**(59) Income of provident funds, superannuation funds, gratuity funds [Section 10(25)]** - Income of a recognized provident fund (RPF) and of an approved superannuation fund or gratuity fund is exempt from tax and the trustees of these funds would not be liable to tax thereon.

The exemption also applies to -

- (i) the interest on securities which are held by or are the property of statutory provident fund (SPF) governed by the Provident Funds Act, 1925;
- (ii) the capital gains, if any arising to it from the sale, exchange or transfer of such securities;
- (iii) any income received by the Board of Trustees constituted under Coal Mines Provident Fund and Miscellaneous Provisions Act, 1984 and under the Employees Provident Funds and Miscellaneous Provisions Act, 1952, on behalf of the Deposit Linked Insurance Funds established under these respective Acts.

**(60) Income tax exemption to Employees State Insurance (ESI) Fund [Section 10(25A)] -** The contributions paid under ESI Act, 1948 and all other moneys received on behalf of the ESI Corporation are paid into a Fund called the ESI Fund. This Fund is held and administered by the ESI Corporation. The amounts lying in the Fund are to be expended for payment of cash benefits and provision of medical treatment and attendance to insured persons and their families, establishment and maintenance of hospitals and dispensaries, etc. Any income of the ESI Fund is exempted.

**(61) Income of member of a scheduled tribe [Section 10(26)] -** A member of a Scheduled Tribe residing in -

- (i) any area (specified in the Constitution) or
- (ii) in the States of Manipur, Tripura, Arunachal Pradesh, Mizoram and Nagaland, or
- (iii) in the Ladakh region of the state of Jammu and Kashmir

is exempt from tax on his income arising or accruing -

- (a) from any source in the areas or States aforesaid.
- (b) by way of dividend or interest on securities.

**(62) Exemption of income of a Sikkimese Individual [Section 10(26AAA)]**

(i) The following income, which accrues or arises to a Sikkimese individual, would be exempt from income-tax -

- (a) income from any source in the State of Sikkim; or
- (b) income by way of dividend or interest on securities.

(ii) However, this exemption will not be available to a Sikkimese woman who, on or after 1st April, 2008, marries a non-Sikkimese individual.

**(63) Exemption of income of an Agricultural Produce Market Committee or Board [Section 10(26AAB)] -** Any income of an Agricultural Produce Market Committee or Board constituted under any law for the time being in force for the purpose of regulating the marketing of agricultural produce would be exempt.

**(64) Income of a corporation etc. for the promotion of interests of members of scheduled casts or tribes or both [Section 10(26B)] -** Any income of a corporation (established by a Central, State or Provincial Act) or other body, institution or association

(wholly financed by Government) formed for promotion of the interests of the members of scheduled castes or tribes or backward classes or of any two or all of them is exempt from tax.

**(65) Exemption of income of corporations established to protect interests of minority community [Section 10(26BB)]** - Any income of a corporation established by the Central Government or any State Government for promoting the interests of the members of a minority community will be exempt from income tax. Section 80G also provides tax relief in respect of donations made to these corporations.

**(66) Exemption of income of corporation established by a Central, State or Provincial Act for welfare of ex-servicemen [Section 10(26BBB)]** - This clause exempts any income of a corporation established by a Central, State or Provincial Act for the welfare and economic upliftment of ex-servicemen, being citizens of India.

**(67) Co-operatives for scheduled castes [Section 10(27)]** - Any income of a co-operative society formed for promoting the interests of the members of either the scheduled castes or scheduled tribes will be exempted from being included in the total income of the society.

**Conditions:** (a) The membership of the co-operative society should consist of only other co-operative societies formed for similar purposes, and

(b) The finances of the society shall be provided by the Government and such other societies.

**(68) Incomes of certain bodies like Coffee Board, etc. [Section 10(29A)]** - Under this clause, any income accruing or arising to the following bodies is exempt from tax:

- (a) the Coffee Board constituted under section 4 of the Coffee Act, 1942,
- (b) the Rubber Board constituted under section 4(1) of the Rubber Board Act, 1947,
- (c) the Tea Board established under section 4 of the Tea Act, 1953,
- (d) the Tobacco Board constituted under the Tobacco Board Act, 1975,
- (e) the Marine Products Export Development Authority established under section 4 of the Marine Products Export Development Authority Act, 1972,
- (f) the Agricultural and Processed Food Products Export Development Authority established under section 4 of the Agricultural and Processed Food Products Export Development Act, 1985,
- (g) the Spices Board constituted under section 3(1) of the Spices Board Act, 1986,
- (h) the Coir Board established under the Coir Industry Act, 1953.

**(69) Tea board subsidy [Section 10(30)]** - The amount of any subsidy received by any assessee engaged in the business of growing and manufacturing tea in India through or from the Tea Board will be wholly exempt from tax.

**Conditions:** (a) The subsidy should have been received under any scheme for replantation or replacement of the bushes or for rejuvenation or consolidation of areas used for cultivation of tea.

(b) The assessee should furnish a certificate from the Tea Board as to the subsidy received by him during the previous year to the Assessing Officer along with his return of the relevant assessment year or within the time extended by the Assessing Officer for the purpose.

**(70) Other subsidies [Section 10(31)]** - Amount of any subsidy received by an assessee engaged in the business of growing and manufacturing rubber, coffee, cardamom or other specified commodity in India from or through the Rubber Board, Coffee Board, Spices Board or any other Board in respect of any other commodity under any scheme for replantation or replacement of rubber, coffee, cardamom or other plants or for rejuvenation or consolidation of areas used for cultivation of all such commodities will be exempt from income-tax. Condition for submission of certificate is applicable.

**(71) Exemption in respect of clubbed income of minor [Section 10(32)]** - In case the income of an individual (i.e. the parent) includes the income of his minor child in terms of section 64(1A), such parent shall be entitled to exemption of ₹ 1,500 in respect of each minor child. However, if income of any minor so includible is less than ₹ 1,500, then the entire income shall be exempt.

#### Illustration 13

*Mr. Khanna has an income from salary of ₹ 3,00,000. Details of income of his minor children are:*

*Minor daughter has earned an interest income from bank FD : ₹ 5,000*

*His minor son has also earned an interest income on NSC : ₹ 1,000.*

*Compute his gross total income for the P.Y. 2014-15.*

#### Solution

##### Computation of Gross Total income of Mr. Khanna for the P.Y.2014-15

Income from Salary				₹ 3,00,000
Income from other sources				
Minor daughter's interest income from bank FD	5,000			
Less: Exempt under section 10(32)	<u>(1,500)</u>	₹ 3,500		
Minor son's interest income on NSC	1,000			
Less: Exempt under section 10(32)	<u>(1,000)</u>	Nil	₹ 3,500	
<b>Gross Total Income</b>				<b><u>₹ 3,03,500</u></b>

**(72) Exemption of capital gain on transfer of a unit of Unit Scheme, 1964 (US 64) [Section 10(33)]** - This clause provides that any income arising from the transfer of specified units, shall be exempt from tax. Such transfer should take place on or after 1.4.2002.

**(73) Exclusion of dividends referred to in section 115-O from total income [Section 10(34)]** - This clause provides that any income by way of dividends referred to in section 115-O shall be exempt. Under section 115-O, any amount declared, distributed or paid by a domestic company by way of dividend shall be subject to dividend distribution tax @ 15% of gross dividend plus surcharge@10% plus education cess@2% plus secondary and higher



education cess@1%. Therefore, a domestic company is liable to pay dividend distribution tax in addition to income-tax chargeable in respect of total income. The dividend income would, however, be exempt in the hands of the shareholder.

**(74) Exemption of income received by an investor on account of buy-back of unlisted shares of a domestic company [Section 10(34A)]**

- (i) Under section 115-O, dividend distribution tax (DDT) is levied on a company at the time when it distributes, declares or pays any dividend to its shareholders. Consequently, the amount of dividend received by the shareholders is not included in the total income of the shareholder, by virtue of exemption provided under section 10(34).
- (ii) The consideration received by a shareholder on buy-back of shares by a company is not treated as dividend but is taxable as capital gains under section 46A.
- (iii) While payment of dividend is one option available to a company to distribute its reserves to its shareholders, another option available is to buy-back its own shares at a consideration determined by it. If the company exercises the former option, the payment of dividend would be subject to DDT under section 115-O and income in the hands of shareholders would be exempt as per section 10(34). However, if the company prefers the second option, the income would be taxed in the hands of shareholder under section 46A as capital gains.
- (iv) In order to discourage the practice of domestic companies resorting to buy back of unlisted shares instead of payment of dividends in order to avoid payment of tax by way of DDT, especially if the capital gains arising to the shareholders are either not chargeable to tax or are taxable at a lower rate, Chapter XII-DA<sup>2</sup>, comprising of sections 115QA, 115QB and 115QC, levies additional income-tax on buy back of such shares by domestic companies.
- (v) The income arising to the shareholders in respect of such buy back of unlisted shares by the domestic company would be exempt under section 10(34A) w.e.f. A.Y.2014-15, where the company is liable to pay the additional income-tax on the buy-back of shares.
- (vi) For this purpose, buyback means purchase by a company of its own shares in accordance with the provisions of section 77A of the Companies Act, 1956.

**(75) Exemption of income from units from the Administrator of specified undertaking / specified company / mutual fund specified in clause (23D) [Section 10(35)]** - This clause provides that any income received in respect of units from the Administrator of the specified undertaking / specified company / Mutual Fund specified under clause (23D) shall be exempt. Exemption shall not apply to any income arising from transfer of such units.

**(76) Exemption of long term capital gains on transfer of listed equity shares [Section 10(36)]** - Any income arising from transfer of a long-term capital asset, being an eligible equity

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<sup>2</sup> Chapter XII-DA is not covered within the syllabus of Intermediate (IPC) Course. Therefore, the provisions of section 115QA, 115QB and 115QC have not been discussed here. These provisions will be dealt with in detail at the Final level.

share in a company purchased on or after 1.3.2003 but before 1.3.2004, and held for a period of 12 months or more shall be exempt from tax.

"Eligible equity share" means –

- (i) any equity share in a company being a constituent of BSE-500 Index of the Stock Exchange, Mumbai as on 1.3.2003 and the transactions of purchase and sale of such equity share are entered into on a recognised stock exchange in India;
- (ii) any equity share in a company allotted through a public issue on or after 1.3.2003 and listed in a recognised stock exchange in India before 1.3.2004 and the transaction of sale of such share is entered into on a recognised stock exchange in India.

**(77) Exemption of capital gains on compulsory acquisition of agricultural land situated within specified urban limits [Section 10(37)]** - With a view to mitigate the hardship faced by the farmers whose agricultural land situated in specified urban limits has been compulsorily acquired, clause (37) has been inserted to exempt the capital gains arising to an individual or a HUF from transfer of agricultural land by way of compulsory acquisition.

Such exemption is available where the compensation or the enhanced compensation or consideration, as the case may be, is received on or after 1.4. 2004.

The exemption is available only when such land has been used for agricultural purposes during the preceding two years by such individual or a parent of his or by such HUF.

#### Illustration 14

*Mr. Kumar has an agricultural land (costing ₹ 6 lakh) in Lucknow and has been using it for agricultural purposes since 1.4.2000 till 1.8.2010 when the Government took over compulsory acquisition of this land. A compensation of ₹ 10 lakh was settled. The compensation was received by Mr. Kumar on 1.7.2014. Compute the amount of capital gains taxable in the hands of Mr. Kumar.*

#### Solution

In the given problem, compulsory acquisition of an urban agricultural land has taken place and the compensation is received after 1.4.2004. This land had also been used for at least 2 years by the assessee himself for agricultural purposes. Thus, as per section 10(37), entire capital gains arising on such compulsory acquisition will be fully exempt and nothing is taxable in the hands of Mr. Kumar in the year of receipt of compensation i.e. A.Y.2015-16.

#### Illustration 15

*Will your answer be any different if Mr. Kumar had by his own will sold this land to his friend Mr. Sharma? Explain.*

#### Solution

As per section 10(37), exemption is available if compulsory acquisition of urban agricultural land takes place. Since the sale is out of own will and desire, the provisions of this section are not attracted and the capital gains arising on such sale will be taxable in the hands of Mr. Kumar.

**Illustration 16**

*Will your answer be different if Mr. Kumar had not used this land for agricultural activities? Explain.*

**Solution**

As per section 10(37), exemption is available only when such land has been used for agricultural purposes during the preceding two years by such individual or a parent of his or by such HUF. Since the assessee has not used it for agricultural activities, the provisions of this section are not attracted and the capital gains arising on such compulsory acquisition will be taxable in the hands of Mr. Kumar.

**Illustration 17**

*Will your answer be different if the land belonged to ABC Ltd. and not Mr. Kumar and compensation on compulsory acquisition was received by the company? Explain.*

**Solution**

Section 10(37) exempts capital gains arising to an individual or a HUF from transfer of agricultural land by way of compulsory acquisition. If the land belongs to ABC Ltd., a company, the provisions of this section are not attracted and the capital gains arising on such compulsory acquisition will be taxable in the hands of ABC Ltd.

**(78) Exemption of long-term capital gains on sale of equity shares / units of an equity oriented fund [Section 10(38)]**

- (i) This clause exempts LTCG on sale of equity shares of a company or units of an equity oriented fund *or unit of a business trust*<sup>3</sup>.
- (ii) This exemption is available only if such transaction is chargeable to securities transaction tax.
- (iii) However, such long term capital gains exempt under section 10(38) shall be taken into account in computing the book profit and income tax payable under section 115JB.
- (iv) "Equity oriented fund" means a fund –
  - (1) where the investible funds are invested by way of equity shares in domestic companies to the extent of more than 65% of the total proceeds of such fund; [The percentage of equity share holding of the fund should be computed with reference to the annual average of the monthly averages of the opening and closing figures], and
  - (2) which has been set up under a scheme of a Mutual Fund specified under clause (23D)

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<sup>3</sup> As per section 2(13A), business trust means a trust registered as an Infrastructure Investment Trust or a Real Estate Investment Trust, the units of which are required to be listed on a recognized stock exchange, in accordance with SEBI regulations and notified by the Central Government in this behalf. The taxability of business trust, as contained in Chapter XII-FA, and the other related provisions would be dealt with at the Final level.

The percentage of equity share holding of the fund should be computed with reference to the annual average of the monthly averages of the opening and closing figures.

#### **Illustration 18**

*Mr. Basu purchased 2,000 equity shares of ABC Ltd. (a listed company) on 1.4.2012 at ₹ 20 per share. He sold all the shares on 1.6.2014 at ₹ 50 per share. He also had to pay securities transaction tax (STT) on the same. Explain the taxability in the hands of Mr. Basu in the year of transfer i.e. A.Y.2015-16.*

#### **Solution**

In the given problem, since the listed equity shares of ABC Ltd. are being sold after 12 months, there is a long-term capital gains (LTCG) on the sale of these shares. Also, STT has also been paid on these shares. Thus, as per section 10(38), the entire LTCG arising on such sale will be fully exempt and nothing is taxable in the hands of Mr. Basu in the year of sale i.e. A.Y.2015-16.

#### **Illustration 19**

*Will your answer be different if these shares were preference shares and not equity shares? Explain.*

#### **Solution**

As per section 10(38), LTCG on sale of eligible equity shares of a company shall be exempt. Since the shares are preference shares and not equity shares, the provisions of this section are not attracted and the capital gains arising on such sale will be taxable in the hands of Mr. Basu in the A.Y. 2015-16.

#### **Illustration 20**

*Will you answer be different if these shares were not listed in a recognised stock exchange? Explain.*

#### **Solution**

As per section 10(38), LTCG on sale of equity shares of a company shall be exempt. However, this exemption is available only if such transaction is chargeable to securities transaction tax. Since the shares are not listed in a recognised stock exchange, STT will not be chargeable, hence the provisions of this section are not attracted and the capital gains arising on such sale will be taxable in the hands of Mr. Basu in the A.Y.2015-16.

#### **(79) Exemption of specified income arising from any international sporting event in India [Section 10(39)]**

- (i) This clause exempts income of the nature and to the extent, arising from any international sporting event in India, to the person or persons notified by the Central Government in the Official Gazette.
- (ii) Such international sporting event should -

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- (1) be approved by the international body regulating the international sport relating to such event;
- (2) have participation by more than two countries;
- (3) be notified by the Central Government in the Official Gazette for the purposes of this clause.

(iii) Accordingly, in exercise of the powers conferred by section 10(39), the Central Government has notified the following for the purposes of exemption under section 10(39):

- (a) the Commonwealth Games Federation, London, United Kingdom as the person;
- (b) the Commonwealth Games 2010 to be held in India, as the international sporting event; and
- (c) the income arising to Commonwealth Games Federation from Commonwealth Games 2010 on account of Host Fee, received or receivable from the Organising Committee Commonwealth Games 2010 Delhi, India amounting to 7.3 million GBP, as the specified income.

**(80) Exemption of certain grants etc. received by a subsidiary from its Indian holding company engaged in the business of generation or transmission or distribution of power [Section 10(40)]**

- (i) This clause exempts income of any subsidiary company by way of grant or otherwise received from an Indian company, being its holding company engaged in the business of generation or transmission or distribution of power.
- (ii) The receipt of such income should be for settlement of dues in connection with reconstruction or revival of an existing business of power generation.
- (iii) The exemption under this clause is available if the reconstruction or revival of any existing business of power generation is by way of transfer of such business to the Indian company notified under section 80-IA(4)(v)(a).

**(81) Exemption of any income from transfer of an asset of an undertaking engaged in the business of generation or transmission or distribution of power [Section 10(41)]**

- (i) This clause exempts income arising from transfer of a capital asset, being an asset of an undertaking engaged in the business of generation or transmission or distribution of power.
- (ii) Such transfer should be effected on or before 31st March, 2006, to an Indian company notified under section 80-IA(4)(v)(a).

**(82) Exemption of specified income of certain bodies or authorities [Section 10(42)]**

- (i) This clause exempts income, of the nature and to the extent, arising to a body or authority, notified by the Central Government.
- (ii) Such body or authority should have been established or constituted or appointed -
  - (a) under a treaty or an agreement entered into by the Central Government with two or more countries or a convention signed by the Central Government;
  - (b) not for the purposes of profit.

**(83) Exemption of income received in a transaction of reverse mortgage [Section 10(43)]**

The Finance Minister had, in his budget speech of Union Budget 2007-08, announced that the National Housing Bank would introduce the Reverse Mortgage scheme. This scheme is for the benefit of senior citizens, who own a residential house property. In order to supplement their existing income, they can mortgage their house property with a scheduled bank or housing finance company, in return for a lump-sum amount or for a regular monthly/quarterly/annual income. The senior citizens can continue to live in the house and receive regular income, without the botheration of having to pay back the loan.

The loan will be given up to, say, 60% of the value of residential house property mortgaged. Also, the bank/housing finance company would undertake a revaluation of the property once every 5 years. The borrower can use the loan amount for renovation and extension of residential property, family's medical and emergency expenditure etc., amongst others. However, he cannot use the amount for speculative or trading purposes.

*The Reverse Mortgage Scheme, 2008, now includes within its scope, disbursement of loan by an approved lending institution, in part or in full, to the annuity sourcing institution, for the purposes of periodic payments by way of annuity to the reverse mortgagor. This would be an additional mode of disbursement i.e., in addition to direct disbursements by the approved lending institution to the Reverse Mortgagor by way of periodic payments or lump sum payment in one or more tranches.*

*An annuity sourcing institution has been defined to mean Life Insurance Corporation of India or any other insurer registered with the Insurance Regulatory and Development Authority.*

**Maximum Period of Reverse Mortgage Loan**

	<i>Mode of disbursement</i>	<i>Maximum period of loan</i>
(a)	<i>Where the loan is disbursed directly to the Reverse Mortgagor</i>	<i>20 years from the date of signing the agreement by the reverse mortgagor and the approved lending institution.</i>
(b)	<i>Where the loan is disbursed, in part or in full, to the annuity sourcing institution for the purposes of periodic payments by way of annuity to the Reverse mortgagor</i>	<i>The residual life time of the borrower.</i>

The bank will recover the loan along with the accumulated interest by selling the house after the death of the borrower. The excess amount will be given to the legal heirs. However, before resorting to sale of the house, preference will be given to the legal heirs to repay the loan and interest and get the mortgaged property released.

Therefore, clause (xvi) of section 47 clarifies that any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government would not amount to a transfer for the purpose of capital gains. Further, section

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10(43) provides that the amount received by the senior citizen as a loan, either in lump sum or in installments, in a transaction of reverse mortgage would be exempt from income-tax.

Capital gains tax liability would be attracted only at the stage of alienation of the mortgaged property by the bank/housing finance company for the purposes of recovering the loan.

**(84) Exemption of income received by any person on behalf of NPS Trust [Section 10(44)]** -The New Pension System (NPS), operational since 1st January, 2004, is compulsory for all new recruits to the Central Government service from 1st January, 2004. Thereafter, it has been opened up for employees of State Government and private sector.

NPS Trust has been set-up on 27th February, 2008 as per the provisions of the Indian Trust Act, 1882 to manage the assets and funds under the NPS in the interest of the beneficiaries. The NPS Trust from the applicability of –

- (i) income-tax on any income received by any person for, or on behalf of, the NPS Trust [Section 10(44)]
- (ii) dividend distribution tax in respect of dividend paid to any person for, or on behalf of, the NPS Trust; and
- (iii) securities transaction tax on all purchases and sales of equity and derivatives by the NPS Trust.

Further, the NPS Trust shall receive all income without any deduction of tax at source. [Section 197A(1E)].

Thus, the NPS Trust, which was set up to manage the assets and funds under the New Pension System in the interest of the beneficiaries, would enjoy a “pass-through status”.

**(85) Exemption of specified allowances and perquisites paid to Chairman or a retired Chairman or any other member or retired member of the UPSC [Section 10(45)]**

- (i) Under the Income-tax Act, 1961, perquisites and allowances received by an employee are taxable under the head “Salaries” unless they are specifically exempted.
- (ii) Section 10(45) exempts specified allowances and perquisites received by Chairman or any other member, including retired Chairman/member, of the Union Public Service Commission (UPSC).
- (iii) The exemption would be available in respect of such allowances and perquisites as may be notified by the Central Government in this behalf.
- (iv) Accordingly, the Central Government has notified the following allowances and perquisites for serving Chairman and members of UPSC, for the purpose of exemption under section 10(45) -
  - (1) the value of rent free official residence,
  - (2) the value of conveyance facilities including transport allowance,
  - (3) the sumptuary allowance and

- (4) the value of leave travel concession.

In case of retired Chairman and retired members of UPSC, the following have been notified for exemption under section 10(45):

- (i) a sum of maximum ₹ 14,000 per month for defraying the service of an orderly and for meeting expenses incurred towards secretarial assistance on contract basis.
- (ii) the value of a residential telephone free of cost and the number of free calls to the extent of ₹ 1,500 pm (over and above free calls per month allowed by the telephone authorities)

***Note** – Tax exemption is also available in respect of certain specified perquisites enjoyed by Chief Election Commissioner/Election Commissioner and judges of Supreme Court on account of the enabling provisions in the respective Acts which govern their service conditions.*

**(86) Exemption of specified income of notified entities not engaged in commercial activity [Section 10(46)]**

- (i) Section 10(46) provides for exemption of income arising to a body or authority or Board or Trust or Commission, the nature and extent of which is to be specified by the Central Government.

- (ii) For availing the benefit of exemption under this clause, the body or authority or Board or Trust or Commission should be set up or constituted by or under a Central, State or Provincial Act or constituted by the Central or State Government with the object of regulating or administering an activity for the benefit of the general public.

- (iii) Further, the body or authority or Board or Trust or Commission should –

- (1) not be engaged in any commercial activity;
- (2) be notified by the Central Government in this behalf.

- (iv) Accordingly, the Central Government has notified that for the purposes of section 10(46), the following income arising to the National Skill Development Corporation (NSDC), a body constituted by the Central Government, for F.Y. 2011-12 to F.Y. 2015-16, shall not be chargeable to tax:

- (1) long-term or short-term capital gain out of investment in an organization for skill development;
- (2) dividend and royalty from skill development venture supported or funded by NSDC;
- (3) interest on loans to Institutions for skill development;
- (4) interest earned on fixed deposits with banks; and
- (5) amount received in the form of Government grants.



Such exemption shall apply if:

- (1) the activities and the nature of the specified income of NSDC remain unchanged throughout the financial year, and
  - (2) NSDC files its return of income in accordance with section 139(4C)(g).
- (v) Further, the Central Government has notified that for the purposes of section 10(46), the following income arising to the Competition Commission of India (CCI), a Commission established under section 7(1) of the Competition Act, 2002, for F.Y. 2011-12 to F.Y. 2015-16, shall not be chargeable to tax:
- (i) amount received in the form of Government grants;
  - (ii) fee received under the Competition Act, 2002; and
  - (iii) interest income accrued on Government grants and interest accrued on fee received under the Competition Act, 2002.

Such exemption shall apply if:

- (i) the activities and the nature of the specified income of CCI remain unchanged throughout the financial year, and
- (ii) CCI files its return of income in accordance with section 139(4C)(g)

**(87) Exemption of income of notified infrastructure debt funds and concessional tax rate on interest received by non-residents from such fund [Section 10(47)]**

- (i) In order to give a fillip to infrastructure and encourage inflow of long-term foreign funds to this sector, the Central Government to notify infrastructure debt funds to be set up in accordance with the prescribed guidelines, the income of which would be exempt from tax.
- (ii) Interest income received by a non-resident or a foreign company from such fund would be subject to tax at a concessional rate of 5% under section 115A on the gross amount of such interest income.

**(88) Exemption in respect of income received by certain foreign companies in India in Indian currency from sale of crude oil to any person in India [Section 10(48)]**

- (i) A mechanism has been devised, in the national interest, to make payment to certain foreign companies in India in Indian currency for import of crude oil.
- (ii) In order to provide exemption in respect of such income in the hands of the foreign company, especially since the payment is made in the interest of the nation, section 10(48) exempts any income of a foreign company received in India in Indian currency on account of sale of crude oil, any other goods or rendering of services, as may be notified by the Central Government in this behalf, to any person, in India. *So far, the National Iranian Oil Company has been notified by the Central Government in this behalf.*
- (iii) The following conditions have to be fulfilled for claim of such exemption –

- (1) The money has been received under an agreement or arrangement which is either entered into, or approved by, the Central Government;
- (2) The foreign company, as well as the arrangement or agreement, are notified by the Central Government having regard to the national interest;
- (3) The foreign company is not engaged in any other activity in India, except receipt of income under such arrangement or agreement.

*Students should carefully note that all the items under section 10 listed above are altogether exempt from taxation and they are not even includible in the total income of the person concerned.*

## 2. Tax Holiday for Newly Established Units in Special Economic Zones [Section 10AA]

A deduction of profits and gains which are derived by an assessee being an entrepreneur from the export of articles or things or providing any service, shall be allowed from the total income of the assessee.

**(1) Assessee who are eligible for exemption:** Exemption is available to all categories of assessee who derive any profits or gains from an undertaking being a unit engaged in the export of articles or things or providing any service. Such assessee should be an entrepreneur referred to in section 2(j) of the SEZ Act, 2005 i.e., a person who has been granted a letter of approval by the Development Commissioner under section 15(9).

**(2) Essential conditions to claim exemption:** The exemption shall apply to an undertaking which fulfils the following conditions:

- (i) It has begun or begins to manufacture or produce articles or things or provide any service on or after 1.4.2005 in any SEZ.
- (ii) It should not be formed by splitting up or reconstruction of a business already in existence (except in circumstances provided in section 33B) or formed by transfer to a new business, of plant and machinery previously used for any purpose exceeding 20% of the total value of machinery and plant used in the business.
- (iii) For this purpose, any machinery or plant which was used outside India by any person other than the assessee shall not be regarded as machinery or plant previously used for any purpose if the following conditions are fulfilled:
  - (a) such machinery or plant was not at any time used in India;
  - (b) such machinery or plant is imported into India from any country outside India; and
  - (c) no deduction on account of depreciation has been allowed in respect of such machinery or plant to any person earlier.
- (iv) The assessee should furnish in the prescribed form [Form No. 56F], alongwith the return of income, the report of a chartered accountant certifying that the deduction has been correctly claimed.

- (v) The conditions laid down in sub-section (8) (relating to inter-unit transfer) and sub-section (10) (relating to showing excess profit from such unit) of section 80-IA shall, so far as may be, apply in relation to the undertaking referred to in this section as they apply for the purposes of the undertaking referred to in section 80-IA.

**(3) Period for which deduction is available:** The unit of an entrepreneur, which begins to manufacture or produce any article or thing or provide any service in a SEZ on or after 1.4.2005, shall be allowed a deduction of:

- (i) 100% of the profits and gains derived from the export, of such articles or things or from services for a period of 5 consecutive assessment years beginning with the assessment year relevant to the previous year in which the Unit begins to manufacture or produce such articles or things or provide services, and
- (ii) 50% of such profits and gains for further 5 assessment years.
- (iii) A further deduction for next 5 consecutive years shall be so much of the amount not exceeding 50% of the profit as is debited to the profit and loss account of the previous year in respect of which the deduction is to be allowed and credited to a reserve account (to be called the "Special Economic Zone Re-investment Reserve Account") to be created and utilised in the manner laid down under section 10AA(2).

**Example:** An undertaking is set up in a SEZ and begins manufacturing on 15.10.2005. The deduction under section 10AA shall be allowed as under:

- (a) 100% of profits of such undertaking from exports from A.Y.2006-07 to A.Y.2010-11.
- (b) 50% of profits of such undertaking from exports from A.Y.2011-12 to A.Y. 2015-16.
- (c) 50% of profits of such undertaking from exports from A.Y.2016-17 to A.Y.2020-21 provided certain conditions are satisfied.

**(4) Conditions to be satisfied for claiming deduction for further 5 years (after 10 years)** [Section 10AA(2)] - Sub-section (2) provides that the deduction under (3)(iii) above shall be allowed only if the following conditions are fulfilled, namely:-

- (a) the amount credited to the Special Economic Zone Re-investment Reserve Account is utilised-
  - (1) for the purposes of acquiring machinery or plant which is first put to use before the expiry of a period of three years following the previous year in which the reserve was created; and
  - (2) until the acquisition of the machinery or plant as aforesaid, for the purposes of the business of the undertaking. However, it should not be utilized for
    - (i) distribution by way of dividends or profits; or
    - (ii) for remittance outside India as profits; or
    - (iii) for the creation of any asset outside India;

(b) the particulars, as may be specified by the CBDT in this behalf, have been furnished by the assessee in respect of machinery or plant. Such particulars include details of the new plant/machinery, name and address of the supplier of the new plant/machinery, date of acquisition and date on which new plant/machinery was first put to use. Such particulars have to be furnished along with the return of income for the assessment year relevant to the previous year in which such plant or machinery was first put to use.

**(5) Consequences of mis-utilisation / non-utilisation of reserve [Section 10AA(3)]:** Where any amount credited to the Special Economic Zone Re-investment Reserve Account -

(a) has been utilised for any purpose other than those referred to in sub-section (2), the amount so utilized shall be deemed to be the profits in the year in which the amount was so utilised and charged to tax accordingly; or

(b) has not been utilised before the expiry of the said period of 3 years, the amount not so utilised, shall be deemed to be the profits in the year immediately following the said period of three years and be charged to tax accordingly [Sub-section (3)].

**(6) Computation of profit and gains from exports of such undertakings:** The profits derived from export of articles or things or services (including computer software) shall be the amount which bears to the profits of the business of the undertaking, being the unit, the same proportion as the export turnover in respect of such articles or things or computer software bears to the total turnover of the business carried on by the undertaking. i.e.

Profits from business of the undertaking being the unit ×

$$\left( \frac{\text{Export turnover of the undertaking of such articles or things or computer software}}{\text{Total turnover of the business carried on by the undertaking}} \right)$$

**(7) Conversion of EPZ / FTZ into SEZ:** Where a Unit initially located in any FTZ or EPZ is subsequently located in a SEZ by reason of conversion of such FTZ or EPZ into a SEZ, the period of 10 consecutive assessment years referred to above shall be reckoned from the assessment year relevant to the previous year in which the Unit began to manufacture, or produce or process such articles or things or services in such FTZ or EPZ.

However, where a unit initially located in any FTZ or EPZ is subsequently located in a SEZ by reason of conversion of such FTZ or EPZ into a SEZ and has already completed the period of 10 consecutive assessment years, it shall not be eligible for further deduction from income w.e.f. A.Y.2006-07.

**Note** - The provisions of erstwhile section 10A shall not apply to any undertaking, being a Unit referred to under section 2(zc) of the SEZ Act, 2005, which has begun or begins to manufacture or produce articles or things or computer software during the previous year relevant to the assessment year commencing on or after the 1.4.2006 in any SEZ. "Unit" as per section 2(zc) of the SEZ Act, 2005 means unit set up by an entrepreneur in a Special Economic Zone and includes an existing Unit, an Offshore Banking Unit and a Unit in an International Financial Services Centre, whether established before or after the commencement of this Act.

**(8) Restriction on other tax benefits**

(i) The loss referred to in section 72(1) or section 74(1)/(3), in so far as such loss relates to the business of the undertaking, being the Unit shall be allowed to be carried forward or set off.

(ii) In order to claim deduction under this section, the assessee should furnish report from a Chartered Accountant in the prescribed form along with the return of income certifying that the deduction is correct.

(iii) During the period of deduction, depreciation is deemed to have been allowed on the assets. Written Down Value shall accordingly be reduced.

(iv) No deduction under section 80-IA and 80-IB shall be allowed in relation to the profits and gains of the undertaking.

(v) Any unabsorbed depreciation under section 32(2) or business loss under section 72(1) or loss under the head "Capital gains" under section 74 of the undertaking, being the Unit shall be allowed to be carried forward and set off in the subsequent years.

(vi) Where any goods or services held for the purposes of eligible business are transferred to any other business carried on by the assessee, or where any goods held for any other business are transferred to the eligible business and, in either case, if the consideration for such transfer as recorded in the accounts of the eligible business does not correspond to the market value thereof, then the profits eligible for deduction shall be computed by adopting market value of such goods or services on the date of transfer. In case of exceptional difficulty in this regard, the profits shall be computed by the Assessing Officer on a reasonable basis as he may deem fit. Similarly, where due to the close connection between the assessee and the other person or for any other reason, it appears to the Assessing Officer that the profits of eligible business is increased to more than the ordinary profits, the Assessing Officer shall compute the amount of profits of such eligible business on a reasonable basis for allowing the deduction.

*(vii) Where a deduction under this section is claimed and allowed in relation to any specified business eligible for investment-linked deduction under section 35AD, no deduction shall be allowed under section 35AD in relation to such specified business for the same or any other assessment year.*

**(9) Deduction allowable in case of amalgamation and demerger** - In the event of any undertaking, being the Unit which is entitled to deduction under this section, being transferred, before the expiry of the period specified in this section, to another undertaking, being the Unit in a scheme of amalgamation or demerger, -

(a) no deduction shall be admissible under this section to the amalgamating or the demerged Unit for the previous year in which the amalgamation or the demerger takes place; and

(b) the provisions of this section would apply to the amalgamated or resulting Unit, as they would have applied to the amalgamating or the demerged Unit had the amalgamation or demerger had not taken place.

**Clarification on issues relating to export of computer software**

Section 10AA provides deduction to assesseees who derive any profits and gains from export of articles or things or services (including computer software) from the year in which the Unit begins to manufacture or produced such articles or things or provide services, as the case may be, subject to fulfillment of the prescribed conditions. *Explanation 2* to the said section clarifies that the profits and gains derived from on site development of computer software (including services for development of software) outside India shall be deemed to be the profits and gains derived from the export of computer software outside India.

**Circular No. 1/2013, dated 17.01.2013** provides certain clarifications in respect of following issues arising out of the said provisions:

	Issue	Clarification given by the CBDT
(1)	Would "On-site" development of computer software qualify as an export activity for tax benefit under section 10AA?	The software developed abroad at a client's place would be eligible for such benefit, because these would amount to 'deemed export'. However, it is necessary that there must exist a direct and intimate nexus or connection of development of software done abroad with the eligible units set up in India and such development of software should be pursuant to a contract between the client and the eligible unit.
(2)	Would receipts from deputation of technical manpower for such "On-site" software development abroad at the client's place be eligible for deduction under section 10AA?	Explanation 2 to section 10AA clarifies that profits and gains derived from 'services for development of software' outside India would also be deemed as profits derived from export. Therefore, profits earned as a result of deployment of technical manpower at the client's place abroad specifically for software development work pursuant to a contract between the client and the eligible unit should not be denied benefit under section 10AA provided such deputation of manpower is for the development of such software and all the prescribed conditions are fulfilled.
(3)	Is it necessary to have separate master service agreement (MSA) for each work contract?	As per the practice prevalent in the software development industry, generally two types of agreement are entered into between the Indian software developer and the foreign client. Master Services Agreement (MSA) is an initial general agreement between a foreign client and the Indian software developer setting out the broad and general terms and conditions of business under the umbrella of which specific and individual Statement of Works (SOW) are formed. These SOWs, in fact, enumerate the specific scope and nature of the particular task or project that has to be rendered by a particular unit under the overall ambit of the

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		<p>MSA. Clarification has been sought whether more than one SOW can be executed under the ambit of a particular MSA and whether SOW should be given precedence over MSA.</p> <p>It is clarified that the tax benefits under section 10AA would not be denied merely on the ground that a separate and specific MSA does not exist for each SOW. The SOW would normally prevail over the MSA in determining the eligibility for tax benefits unless the Assessing Officer is able to establish that there has been splitting up or reconstruction of an existing business or non-fulfillment of any other prescribed condition.</p>
(4)	Would tax benefit under section 10AA continue to be available in case of a slump sale of a unit?	<p>The answer to this issue would depend on the facts of each case, such as how a slump-sale is made and what is its nature. It will also be important to ensure that the slump sale would not result into any splitting or reconstruction of existing business.</p> <p>It is, however, clarified that on the sole ground of change in ownership of an undertaking, the claim of exemption cannot be denied to an otherwise eligible undertaking and the tax holiday can be availed of for the unexpired period at the rates as applicable for the remaining years, subject to fulfillment of prescribed conditions.</p>
(5)	Can tax benefits under section 10AA be enjoyed by an eligible SEZ unit consequent to its transfer to another SEZ?	<p>It is clarified that the tax holiday should not be denied merely on the ground of physical relocation of an eligible SEZ unit from one SEZ to another in accordance with Instruction No. 59 of Department of Commerce, if all the prescribed conditions are satisfied under the Income-tax Act, 1961.</p> <p>It is further clarified that the unit so relocated will be eligible to avail of the tax benefit for the unexpired period at the rates applicable to such years.</p>
(6)	Whether new units set up in the same location where there is an existing eligible unit would amount to expansion of the existing unit?	<p>This issue is a matter of fact requiring examination and verification. However, it has been clarified that setting up of such a fresh unit in itself would not make the unit ineligible for tax benefits, provided –</p> <ul style="list-style-type: none"> <li>(i) the unit is set-up after obtaining necessary approvals from the competent authorities;</li> <li>(ii) it has not been formed by splitting or reconstruction of an existing business; and</li> <li>(iii) it fulfils all other conditions prescribed under section 10AA.</li> </ul>

### 3. Charitable or Religious Trusts and Institutions [Sections 11 to 13]

(1) **General discussion on trusts** - Before considering the provisions of sections 11 to 13 which govern the exemption in respect of income from property held for charitable or religious purposes, let us see briefly what exactly the term trust signifies, the types of trusts and the manner of their creation. Though this aspect of the topic does not strictly fall within the purview of Income-tax, such a general knowledge would be useful in understanding the provisions of tax laws relating to charitable trusts.

A trust is an obligation annexed to the ownership and arising out of a confidence reposed in and accepted by the owner if declared and accepted by him for the benefit of another or of another and the owner. The person who reposes or declares the confidence is called the 'author of the trust'; the person who accepts the confidence is called the trustee; the person for whose benefit the confidence is accepted is called the 'beneficiary'; the subject matter of the trust is called the 'trust property'; the 'beneficial interest' or 'interest' of the beneficiary is his right against the trustees or owner of the trust property and the instrument, if any, by which trust is declared is called the 'instrument of trust'.

Trusts can be broadly classified into two groups - Public and Private. The distinction between a public and private trust is that, whereas in the former, the beneficiaries are the general public or a class thereof, in the latter they are specific individuals. While in the former the beneficiaries constitute a body which is incapable of ascertainment, in the latter they are persons who are ascertained or capable of being ascertained. In some cases, private trusts may ensure for the benefit of the public. Some religious trust may also be in the nature of public-cum-private trust.

Private trusts are governed by the Indian Trust Act, 1882. This Act does not apply to the following:

- (1) The rules of Mohammedan law as to wakf;
- (2) The mutual relations of the members of undivided family as determined by any customary or personal law;
- (3) Public or private religious or charitable endowments; and
- (4) Trust to distribute prizes taken in war among the captors.

From the above, it will be clear that public charitable trusts are not governed by the Indian Trust Act.

There are three requirements for creation of a public trust. They are (1) a declaration of trust which is binding on the settlor, (2) setting apart definite property and depriving himself of the ownership, and (3) a statement of subjects for which the property is thereafter to be held. In the case of a private trust also, more or less similar requirements exist.

The word 'trust' as used in the context of sections 11 to 13 includes, in addition to the 'trust' as explained above, 'any other legal obligation'. This is made clear in Explanation 1 to section 13. The words 'any other legal obligation' are wide enough to cover Muslim wakfs, Hindu endowments and dedications to deities. It would also cover a case in which the trustees of a



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settlement are to pay the income to other trustees who in their turn are bound to apply it for purposes which are religious or charitable.

#### **(2) Tax Exemption [Section 11]**

(i) Subject to the provisions of sections 60 to 63, the income of a religious or charitable trust or institution, to the extent specified in the Act, is exempt from tax when certain prescribed conditions are fulfilled. The relevant income does not even form part of the total income of the trust or institution.

(ii) Section 11 deals with the exemption of income from property held in trust or other legal obligation for religious or charitable purposes wholly or in part. Section 12 deals with exemption of income derived by such a trust from voluntary contributions. Section 12A prescribes the conditions as to registration of trust etc. Section 13 enumerates the circumstances under which the exemption available under sections 11 to 12 will be denied.

**(iii) Income from property held for charitable or religious purposes** - The following income shall not be included in the total income of the previous year of the person in receipt of the income:

- (a) Income derived from property held under trust wholly for charitable and religious purposes to the extent such income is applied in India for such purpose.
- (b) Income derived from property held under trust in part only for such purpose, to the extent such income is applied in India for such purposes. However, the trust in question must have been created before 1.4.1962.
- (c) Income derived from property held under trust, created on after 1.4.1952 for charitable purpose which tends to promote international welfare in which India is interested to the extent to which such income is applied to such purpose outside India. This does not cover religious trusts.
- (d) Income derived from property held under a trust for charitable or religious purposes, created before 1.4.1952, to the extent to which such income is applied for such purposes outside India.
- (e) Income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution.

Thus, it may be noted that only such income derived from property held under trust wholly for charitable or religious purposes is exempt. If the property is held in part only for such purposes, it is necessary that such a trust must have been created before the commencement of the Act. In both the cases, the exemption is limited to the extent such income is applied in India for such specified purposes.

**(iv) Types of trusts** - To get exemption in respect of income applied outside India, the trusts are divided into two types:

- (a) If the object of the trust is to promote international welfare in which India is interested, such trust may have been created on or after 1.4.1952.

- (b) If the trust is for any other charitable purpose it must have been created before 1.4.1952. Here also, the exemption is limited to the extent to which such income is applied outside India for such specified purposes. It is to be noted however that a direction from CBDT by a general or special order is necessary before such exemption can be claimed.

**(v) Conditions for claiming exemption**

- (a) **Property should be held under trust** - The exemptions explained in the preceding paragraphs are available if and only if there is a valid trust or there is a legal obligation, under which the income derived from the property held under such trust or legal obligation is to be applied for charitable or religious purposes. If there is no trust nor any legal obligation, the income will not be exempt even if the whole of such income is applied to charitable or religious purposes. A mere creation of a trust for the income is not sufficient, there must be a trust of the property out of which the income is derived before one can consider any exemption under section 11.
- (b) **Income should be applied for charitable purposes** - Section 2(15) states that 'charitable purpose' includes relief of the poor, education, medical relief, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest and the advancement of any other object of general public utility.

The definition of "charitable purpose" includes "any other object of general public utility". The question arises as to what is an object of "general public utility". This expression has not been defined anywhere in the Act.

In *CIT v. Gujarat Maritime Board (2007) 295 ITR 561*, the Supreme Court observed that the Gujarat Maritime Board was established for the predominant purpose of development of minor ports within the State of Gujarat, the management and control of the Board was essentially with the State Government and there was no profit motive. The assessee, Gujarat Maritime Board, was under a legal obligation to apply its income which was directly and substantially from the business held under trust for the development of minor ports in Gujarat. Therefore, the Supreme Court held that the assessee was entitled to be registered as "charitable trust" under section 12A.

A number of entities functioning on commercial basis claim exemption of their income either under section 10(23C) or section 11 on the foundation that they are charitable institutions. This is based on the contention that they are engaged in the "advancement of an object of general public utility" as is included in the fourth part of the present definition of "charitable purpose". There were many decisions rendered in the past supporting the view that if unconnected business is held under a trust for promoting the object of general public utility and if profits are used for promoting such objects, income thereof shall be exempt, for example, the decision of the Supreme Court in *CIT v. Madras Stock Exchange Ltd. (1981) 130 ITR 184*. However, such a claim in respect of an activity carried out on commercial basis, goes against the basic intention of the provision.

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Therefore, in order to limit the ambit of the phrase “advancement of any other object of general public utility”, section 2(15) has been amended to provide that “the advancement of any other object of general public utility” would not be a charitable purpose if it involves the carrying on of –

- (a) any activity in the nature of trade, commerce or business or,
- (b) any activity of rendering of any service in relation to any trade, commerce or business, for a fee or cess or any other consideration, irrespective of the nature of use or application of the income from such activity, or the retention of such income, by the concerned entity.

Therefore, the institutions which were engaged in charitable activities and having the object of general public utility were denied exemption, if they were engaged in any activity of trade, commerce or business or activity of rendering any service in relation to any trade, commerce or business for a cess or fees.

In order to provide relief to the genuine hardship faced by charitable organizations which receive marginal consideration from such activities, it has been provided that such benefit of exemption will not be denied to the institutions having object of advancement of general public utility, even where they are engaged in the activity of trade, commerce or business or rendering any service for a cess or fee, provided the aggregate value of receipts from such activities does not exceed ₹ 25 lakh in the year under consideration.

Therefore, in effect, “advancement of any other object of general public utility” would continue to be a “charitable purpose”, if the total receipts from any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business does not exceed ₹ 25 lakh in the previous year.

This amendment may have the effect of changing the “charitable” status of the trust/institution every year depending on whether or not the total receipts from such activities exceed ₹ 25 lakh in that year.

#### Illustration 21

*An institution having its main object as “advancement of general public utility” received ₹ 30 lakhs in aggregate during the P.Y.2014-15 from an activity in the nature of trade. It applied 85% of its receipt from such activity during the same year for its main object i.e. advancement of general public utility.*

- (i) *What would be the tax consequence of such receipt and application thereof by the institution?*
- (ii) *Would your answer be different if the institution had received ₹ 23 lakhs (instead of ₹ 30 lakhs) in aggregate during the P.Y.2014-15 from an activity in the nature of trade?*
- (iii) *What would be your answer if the main object of the institution is “relief of the poor” and the institution receives ₹ 30 lakhs from a trading activity and applies 85% of the said receipts for its main object?*

**Solution**

- (i) As the main object of the institution is "advancement of object of general public utility", the institution will lose its "charitable" status for the P.Y.2014-15, since it has received ₹ 30 lakhs from an activity in the nature of trade. The application of 85% of such receipt for its main object during the year would not help in retaining its "charitable" status for that year. The institution will lose its charitable status and consequently, the benefit of exemption of income for the P.Y.2014-15, irrespective of the fact that its approval is not withdrawn or its registration is not cancelled.
- (ii) If the institution receives only ₹ 23 lakhs in aggregate from an activity in the nature of trade during the P.Y.2014-15, then it will not lose its "charitable" status since receipt of upto ₹ 25 lakhs in a year from such activity is permissible. The institution can claim exemption subject to fulfillment of other conditions under sections 11 to 13.
- (iii) The restriction regarding carrying on of a trading activity for a cess, fee or other consideration will not apply if the main object of the institution is "relief of the poor". Therefore, receipt of ₹ 30 lakhs from a trading activity by such an institution will not affect its "charitable" status. The institution can claim exemption subject to fulfillment of other conditions under sections 11 to 13.

**Circular No.11/2008 dated 19.12.2008****Exemption under section 11 in case of an assessee claiming both to be a charitable institution as well as a mutual organisation**

The proviso to section 2(15) will apply only to entities whose purpose is advancement of any other object of general public utility i.e. the last limb of the definition of charitable purpose contained in section 2(15). Hence, such entities will not be eligible for exemption under section 11 or under section 10(23C) if they carry on commercial activities. Whether such an entity is carrying on an activity in the nature of trade, commerce or business is a question of fact which will be decided based on the nature, scope, extent and frequency of the activity.

There are industry and trade associations who claim exemption from tax under section 11 on the ground that their objects are for charitable purpose as these are covered under any other object of general public utility. Under the principle of mutuality, if trading takes place between persons who are associated together and contribute to a common fund for the financing of some venture or object and in this respect have no dealings or relations with any outside body, then any surplus returned to the persons forming such association is not chargeable to tax. In such cases, there must be complete identity between the contributors and the participants.

Therefore, where industry or trade associations claim both to be charitable institutions as well as mutual organizations and their activities are restricted to contributions from and participation of only their members, these would not fall under the purview of the proviso to section 2(15) owing to the principle of mutuality. However, if such organizations have dealings

with non-members, their claim to be charitable organizations would now be governed by the additional conditions stipulated in the proviso to section 2(15).

In the final analysis, however, whether the assessee has for its object the advancement of any other object of general public utility is a question of fact. If such assessee is engaged in any activity in the nature of trade, commerce or business or renders any service in relation to trade, commerce or business, it would not be entitled to claim that its object is charitable purpose. In such a case, the object of general public utility will be only a mask or a device to hide the true purpose which is trade, commerce or business or the rendering of any service in relation to trade, commerce or business. Each case would, therefore, be decided on its own facts and no generalization is possible.

**Circular No. 395, dated 24.9.1984** - Promotion of sports and games is considered to be charitable purposes within the meaning of section 2(15). Therefore, an association or institution engaged in the promotion of games and sports can claim exemption under section 11 even if it is not approved under section 10(23).

A trust will be treated as a charitable trust under section 2(15) even if its object involves the carrying on of an activity for profit. Such a trust will not be denied exemption under section 11 on the ground that its objects are non-charitable.

**(vi) Application and accumulation** - We have seen that the exemption is limited to the extent to which such income is applied in India or outside India as the case may be. Is it necessary that the entire income should be so applied? The Act gives a concession here. It is possible to claim the exemption even if the trust or institution applies only 85 per cent of the income derived from the trust property for the purpose of the trust, during the relevant previous year.

An accumulation not exceeding 15 per cent of the income from such property is permissible. For computing this 15 per cent, voluntary contributions referred to in section 12 shall be deemed to be part of the income. It must be clearly noted that accumulation must be with the object of application of the accumulated amount to charitable or religious purpose in India at a later date. Such a facility for accumulation is not available for those trusts whose income is to be applied outside India.

**(vii) Inability to apply in full 85 per cent of the income** - It is clear from the above discussion that free accumulation not exceeding 15 per cent of income from property is permissible. Hence, the balance 85 per cent must be applied during the previous year for the purposes for which the trust has been created. However, it is possible that the trust is unable to apply the minimum of 85 per cent of its income during the previous year due to either of the following reasons.

- (1) The whole or any part of the income has not been received during that year.
- (2) Any other reason.

In the first class of cases, the period of application is extended to cover the previous year in

which the income is actually received and the previous year immediately following the year. But the amount which may be so claimed to have been so applied during the subsequent previous year cannot exceed the amount of the income which had not been received earlier but received during a subsequent previous year.

*Example 1 - During the previous year ending 31st March, 2015, a charitable trust earned an income of ₹ 1,00,000 but it received only ₹ 60,000 in that year. The balance of ₹ 40,000 is received in the year ending 31-3-2016.*

	₹
Total income earned during the P.Y.2014-15	1,00,000
Actual receipt in P.Y.2014-15	60,000
Permissible accumulation @15% of ₹ 1,00,000	15,000
Balance to be applied during P.Y. 2014-15	45,000
Amount received in P.Y.2015-16 to be applied in P.Y.2015-16 or P.Y.2016-17	40,000

Since this amount of ₹ 40,000 is received during the P.Y. 2015-16, this can be applied in the P.Y.2015-16 or in the P.Y. 2016-17. If the entire amount of ₹ 40,000 is duly spent for charitable purposes in these two years, the exemption is fully available but if only part of the amount is so spent within the period, the exemption is restricted to that part only.

There may be a case where the inability springs from some other reason *e.g.* late receipt of the income making it impossible to spend it before the end of the year.

*Example 2 - A trust receives a sum of ₹ 50,000 on 30th March, 2015. Its previous year ends on 31-3-2015.*

It is obvious that it is impossible to apply the requisite sum within one day. Therefore, it has been provided that such sum can be applied at any time during the immediately following previous year i.e. up to 31-3-2016.

**(viii) Formalities: Exercise of option** - To avail the facility of the extended period of application of income, the trust has to exercise an option in writing that the income applied later as prescribed may be deemed to be income applied to the relevant charitable purposes during the previous year in which the income was derived.

Such option has to be exercised before the expiry of the time allowed statutorily under section 139(1).

The income so deemed to have been applied shall not however be taken into account in calculating the amount of income applied to such purposes, during the previous year in which the income is actually received or during the immediately following previous year as the case may be. Thus, in the Example I given above, the amount of ₹ 40,000, received subsequently in the year 2015-16 and applied to charitable purposes in the year 2015-16, will by virtue of the option exercised by the trust, be deemed to be applied for charitable purposes in the year 2014-15 itself. Therefore, such an amount will not be taken into consideration in determining the amount of income applied for charitable purposes in the year 2015-16.

Sub-section (1B) of section 11 provides that where the income for which an option has been exercised as discussed above, is not actually applied, it is to be treated as the income of the previous year immediately following the year of receipt or the previous year in which it was derived as the case may be.

**(ix) Conditional accumulation** - Apart from the provision for accumulation upto 15 per cent, a trust has also got the rights for conditional accumulation. The relevant provisions are contained in section 11(2).

Where 85 per cent of the income is not applied or is not deemed to have been applied to charitable or religious purposes in India but is accumulated or set apart either wholly or in part for application to such purposes in India, such income shall not be included in the total income of the previous year if the following conditions are satisfied.

- (a) A notice in writing is given to the Assessing Officer in the prescribed manner specifying the purpose for accumulation and the period for which the income is to be accumulated or set apart. Such period should not exceed five years.

Any amount credited or paid, out of income which is accumulated or set apart, to any trust or institution registered under section 12AA or to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) of clause (23C) of section 10, shall not be treated as application of income for charitable or religious purposes, either during the period of accumulation or thereafter.

- (b) The money so accumulated or set apart should be invested or deposited in the following modes specified in section 11(5):

- (1) Investment in Government Saving Certificates.
- (2) Deposits with Post Office Savings Banks.
- (3) Deposit with Scheduled banks or Co-operative Banks.
- (4) Investment in units of the Unit Trust of India.
- (5) Investment in Central or State Government Securities.
- (6) Investments in debentures issued by or on behalf of any company or corporation. However, both the principal and interest thereon must have been guaranteed by the Central or the State Government.
- (7) Investment or deposits in any public sector company.

Where an investment is made in the shares of any public sector company and such public sector company ceases to be a public sector company, the investment so made shall be deemed to be an investment made for a period of three years from the date of such cessation and in the case of any other investment or deposit, till the date of its maturity.

- (8) Investment in bonds of approved financial corporation providing long term finance

for industrial development in India and eligible for deduction under section 36(1)(viii).

- (9) Investment in bonds of approved public companies whose principal object is to provide long-term finance for construction or purchase of houses in India for residential purposes and eligible for deduction under section 36(1)(viii).
- (10) Deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for urban infrastructure in India.

"Long-term finance" means any loan or advance where the terms under which moneys are loaned or advanced provide for repayment along with interest thereof during a period of not less than five years.

"Urban infrastructure" means a project for providing potable water supply, sanitation and sewerage, drainage, solid waste management, road, bridges and flyovers or urban transport.

- (11) Investment in immovable property excluding plant and machinery, not being plant and machinery installed in a building for the convenient occupation thereof.
- (12) Deposits with Industrial Development Bank of India.
- (13) Any other mode of investment or deposit as may be prescribed. Rule 17C specifies the following other modes: (1) Investments in units issued under any scheme of mutual fund referred to in section 10(23D); (2) Any transfer of deposits to Public Account of India; (3) Deposits made with an authority constituted in India or under any law enacted either for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages, or for both; (4) investment by way of acquiring equity shares of a 'depository'; (5) investment by a recognized Stock Exchange, in the equity shares of a company promoted by it to acquire the membership rights of other stock exchanges, where at least 51% of the paid-up share capital is held by the Stock Exchange and the balance is held by its members; (6) investment by way of acquiring equity shares of an incubatee by an incubator; (7) investment in debt instruments issued by any infrastructure finance company registered with RBI.

Where the income of the trust -

- (a) is applied for purposes other than charitable or religious purposes; or
- (b) ceases to be accumulated or set apart for application thereto; or
- (c) ceases to remain invested or deposited in any modes mentioned under section 11(5) above; or



- (d) is not utilised for the purpose for which it is so accumulated or set apart during the period specified (not exceeding 5 years) or in the year immediately following thereof.

However, in computing the aforesaid period of 5 years, the period during which the income could not be applied for the purposes for which it is so accumulated or set apart due to an order or injunction of any Court shall be excluded.

- (e) accumulated or set apart for application to charitable and religious purposes in India, is credited or paid to any trust or institution registered under section 12AA or to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or (v) or (vi) or (via) of clause (23C) of section 10,

such income shall be deemed to be the income of the previous year –

- (a) in which it is so applied; or
- (b) in which it ceases to be accumulated or set apart; or
- (c) in which it ceases to remain so invested or deposited; or
- (d) immediately following the expiry of the period aforesaid; or
- (e) in which it is paid or credited.

It is possible that due to circumstances beyond the control of the person in receipt of the income, any income invested or deposited in approved modes cannot be applied for the purpose for which it was accumulated or set apart. In such a case, an application may be made to the Assessing Officer specifying such other purposes as are in conformity with the objects of the trust. The Assessing Officer may allow the application of income to such other purposes. If such a permission is granted by the Assessing Officer, the new purposes will be deemed to be purposes specified in the written notice given to the Assessing Officer.

It is to be noted that the Assessing Officer cannot allow transfer of any such accumulated income to other charitable trusts/institutions as application of income towards charitable purposes. This has created genuine problems for those trusts and institutions which are wound up. However, in case of a trust or institution which has invested or deposited its income in any of the forms mentioned in section 11(5), the Assessing Officer can allow application of such income for crediting or payment to any trust or institution registered under section 12AA or any fund or institution or trust or university or education institution or hospital or medical institution covered by section 10(23C). Such application can be allowed only in the year in which such trust or institution is dissolved.

***(x) Income for the purposes of application under section 11 shall be determined without allowing any deduction or allowance for depreciation or otherwise, in respect of any asset, the cost of acquisition of which has been claimed as an application of income under this section in the same or any other previous year [Section 11(6)].***

*(xi) Where a trust or an institution has been granted registration for purposes of availing exemption under section 11, and the registration is in force for a previous year, then such trust or institution cannot claim any exemption under any provision of section 10 [other than exemption of agricultural income under section 10(1) and exemption available under section 10(23C)] [Section 11(7)].*

**(xii) Cases where trust property consists of a business undertaking** - Section 11(4) clarifies that for the purposes of section 11, property held under trust may consist of a business undertaking so held. If that be so, the trustees may claim that the income of such undertaking enjoys exemption under section 11. Section 11(4) provides for two things -

- (1) The Assessing Officer shall have the power to determine the income of the undertaking in accordance with the provisions of the Act relating to assessment, and
- (2) Where the income determined by the Assessing Officer is in excess of that shown in the books of the undertaking, such excess shall be deemed to be applied to purposes other than charitable or religious purposes and accordingly be deemed to be the income of the previous year in which it has been deemed to have been so applied.

**(xiii) Charitable trust engaged in business activity [Section 11(4A)]** - Consequently, a charitable trust engaged in business activity will be liable to any tax on income from the activity. However, exemption would be available to the trust in respect of income earned from such business activity if -

- (i) such business is incidental to the attainment of the objects of the trust/institution; and
- (ii) separate books of account are maintained by such trust/institution in respect of such business.

*Note* - Profits derived by a trust/institution referred to in clauses (21), (23A), (23B), (23BB) and (23C) of section 10 will continue to be exempt from income-tax, since section 11(4A) does not override the provisions of section 10.

**(xiv) Instances where capital gains would be deemed to have been applied for charitable purposes [Section 11(1A)]**

- (a) Transfer of a capital asset held under trust wholly for charitable or religious purposes [Section 11(1A)(a)]** - Where the whole of the net consideration from the transfer of the capital asset is utilised for acquiring a new capital asset which is held under trust wholly for charitable or religious purposes, the entire amount of capital gains arising from the transfer would be deemed to have been applied for charitable or religious purposes. If, however, only a part of the net consideration is utilised in acquiring the new capital asset, the amount of capital gains deemed to have been utilised for charitable or religious purposes shall be equal to the excess of the proceeds utilised over the cost of the asset transferred.

**Example**

Original cost of capital asset transferred	₹ 1,00,000
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Consideration for which it is transferred	₹ 1,50,000
Situation 1 Cost of new capital asset acquired	₹ 1,50,000
Situation 2 Cost of new capital asset acquired	₹ 1,20,000
Amount that will be deemed to have been applied for charitable purposes.	
Situation 1	₹ 50,000
Situation 2	₹ 20,000

- (b) **Transfer of a capital asset held under trust in part only for charitable and religious purposes [Section 11(1A)(b)]** - Where only a part of a capital asset has been transferred, only the "appropriate fraction" of the capital gain arising from the transfer shall be deemed to have been applied to charitable or religious purposes. Where the whole of the net consideration is utilised in acquiring the new capital asset, the whole of the appropriate fraction of such capital gain will be deemed to have been so applied. In any other case, the exemption will be limited to so much of the appropriate fraction of the amount utilised for acquiring the new asset as exceeds the appropriate fraction of the cost of the transferred asset.

"Appropriate fraction" means the fraction which represents the extent to which the income derived from the capital asset transferred was applicable to charitable or religious purposes before such transfer.

**Example:** A capital asset is being held under trust. Two-thirds of the income derived from such capital asset are being utilised for the charitable purposes of the trust. The asset is being transferred.

Cost of transferred asset	₹ 1,20,000
Net consideration	₹ 1,80,000
Cost of new asset acquired	₹ 1,50,000
Capital gains	₹ 60,000 [₹ 1,80,000 – ₹ 1,20,000]
Appropriate fraction	2/3rd

Income represented by 'appropriate fraction' = 2/3rds of ₹ 60,000 = ₹ 40,000

Since the entire net consideration has not been utilised in acquiring the new asset, the amount deemed to have been utilised for charitable purpose will be (2/3rds of ₹ 1,50,000) – (2/3rds of ₹ 1,20,000) = ₹ 1,00,000 – ₹ 80,000 = ₹ 20,000.

- (xv) **Voluntary Contributions [Section 12]** - Any voluntary contribution received by a trust created wholly for charitable or religious purposes or by an institution established wholly for such purposes shall for the purposes of section 11, be deemed to be income derived from property held under trust wholly for charitable or religious purposes. However, corpus donations (i.e. contributions made with a specific direction that they shall form part of the corpus of the trust or institution) shall not be treated as income. Such corpus donations are treated as capital receipts not chargeable to tax. Other voluntary contributions would be

treated as income. However, exemption can be claimed in respect of such income subject to fulfillment of the conditions mentioned below –

- (i) The trust should be registered under section 12AA with the *Principal Commissioner or* Commissioner of Income-tax;
- (ii) If the total income of the trust exceeds the basic exemption limit, the accounts of the trust should be audited.
- (iii) The trust should apply at least 85% of its income for the approved purposes.
- (iv) The balance should be invested or deposited in specified forms or modes.

*Note* – It may be noted that the corpus donations are to be considered for the purpose of determining whether the accounts of the trust are to be audited. Further, corpus donations have to be invested only in the investments approved under section 11(5). If invested elsewhere, the income from unapproved investment would be chargeable to tax.

### **(3) Conditions for applicability of sections 11 & 12 [Section 12A]**

(i) The exemption provisions contained in section 11 and 12 as explained above shall not apply in relation to the income of any trust or institution unless the following conditions are satisfied:

- (a) A charitable or religious trust or institution is required to make an application for registration in the prescribed form and in the prescribed manner to the *Principal Commissioner or* Commissioner. The trust should be registered under section 12AA. In such cases, the exemption provisions of section 11 and 12 would apply from the date of creation of the trust or establishment of the institution [Section 12A(1)].

This requirement of filing an application for registration under section 12A within one year of creation of the religious or charitable trust or institution has been removed. The application can be filed at any time now.

Accordingly, in respect of applications filed on or after 1<sup>st</sup> June, 2007, the provisions of sections 11 and 12 shall apply from the assessment year relevant to the financial year in which the application is made i.e. the exemption would be available only with effect from the assessment year relevant to the previous year in which the application is filed. It would not be available in respect of any earlier assessment year [Section 12A(2)].

Thus, under section 12A, a trust or an institution can claim exemption under sections 11 and 12 only after registration under section 12AA has been granted. Also, in case of trusts or institutions which apply for registration after 1<sup>st</sup> June, 2007, the registration shall be effective only prospectively.

Non-application of registration for the period prior to the year of registration causes genuine hardship to charitable organisations. On account of non-registration, tax liability gets attracted in those years even though they may otherwise be eligible for exemption due to compliance with other substantive conditions. Further, condonation of delay in seeking registration is also not permitted.

Therefore, three provisos have been inserted in section 12A by the Finance (No.2) Act,

2014, in order to remove the genuine hardship and provide relief to the trusts.

**Circumstance when exemption would be granted for an earlier assessment year:** *In case where a trust or institution has been granted registration under section 12AA, the benefit of sections 11 and 12 shall be available in respect of any income derived from property held under trust in any assessment proceeding for an earlier assessment year which is pending before the Assessing Officer as on the date of such registration.*

**Condition for grant of such exemption:** *The objects and activities of such trust or institution in the relevant earlier assessment year should be the same as those on the basis of which such registration has been granted.*

**Reassessment proceedings not to be initiated for earlier years due to reason of non-registration:** *No action for reopening of an assessment under section 147 shall be taken by the Assessing Officer in the case of such trust or institution for any assessment year preceding the first assessment year for which the registration applies, merely for the reason that such trust or institution has not obtained the registration under section 12AA for the said assessment year.*

**Non-availability of above benefits to a trust or institution in certain cases:** *The above benefits would, however, not be available in case of any trust or institution which at any time had applied for registration and the same was denied or a registration granted to it was cancelled at any time under section 12AA.*

- (b) **Audit** - Where the total income of the trust without giving effect to the provisions of section 11 and 12 exceeds the maximum amount which is not chargeable to income-tax in any previous year, the accounts of the trust must be audited by a chartered accountant and the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such prescribed particulars, should be furnished along with the return.
- (ii) **Procedure for Registration [Section 12AA]** - Accordingly, the **Principal Commissioner or Commissioner**, on receipt of an application for registration of a trust or institution made under section 12A(1) shall proceed as follows :
- (a) He would call for such documents or information from the trust or institution as he thinks necessary in order to satisfy himself about the genuineness of activities of the trust or institution and may also make such enquiries as he may deem necessary in this behalf.
  - (b) After satisfying himself about the objects of the trust or institution and the genuineness of its activities, he shall pass an order in writing registering the trust or institution.
  - (c) If he is not satisfied, he shall pass an order in writing refusing to register the trust or institution.
  - (d) A copy of such an order issued under (b) or (c) above shall be sent to the applicant. However, an order under (c) shall not be passed unless the applicant has been given a reasonable opportunity of being heard.

- (e) Every order granting or refusing registration shall be passed within six months from the end of the month in which the application for registration of trust or institution is received by the **Principal Commissioner or** Commissioner.
- (f) Where a trust or an institution has been granted registration and subsequently, if the **Principal Commissioner or** Commissioner of Income-tax is satisfied that the activities of any trust or institution are not genuine or are not being carried out in accordance with the objects of the trust or institution, he can pass an order in writing canceling the registration granted under section 12AA and 12A (as it stood before its amendment by the Finance (No.2) Act, 1996). However, the trust or institution should be given a reasonable opportunity of being heard.
- (g) Any order passed by the **Principal Commissioner or** Commissioner of Income-tax under section 12AA refusing registration is appealable under section 253 to the Income-tax Appellate Tribunal.
- (h) *Where a trust or an institution has been granted registration, and subsequently it is noticed that its activities are being carried out in such a manner that,—*
  - (i) *its income does not enure for the benefit of general public;*
  - (ii) *it is for benefit of any particular religious community or caste;*
  - (iii) *any income or property of the trust is applied for benefit of specified persons like author of trust, trustees etc.; or*
  - (iv) *its funds are invested in prohibited modes,**then, the Principal Commissioner or the Commissioner may cancel the registration of such trust or institution. However, if the trust or institution proves that there was a reasonable cause for the activities to be carried out in the above manner, the registration shall not be cancelled.*
- (4) **Denial of Exemption [Section 13]**
  - (i) The following incomes of charitable or religious trusts and institutions would not be eligible for exemption under sections 11 and 12:
    - (a) Where the property is held under a trust for private religious purposes, no part of the income will be exempt if it does not ensure for the benefit of the public [Section 13(1)(a)].
    - (b) Where a trust has been established for the benefit of any particular religious community or caste, the income thereof will not be eligible for exemption. However, a trust or institution created or established for the benefit of scheduled caste, backward classes, scheduled tribes or women and children shall not be treated as a trust or institution created or established for the benefit of a religious community or caste within the meaning of section 13(1)(b).
    - (c) Where the trust or the institution has been created or established after 31.3.1962, if any part of its income enures directly or indirectly for the benefit of any person referred to in section 13(3) [Section 13(1)(c)].

- (d) Irrespective of the date of the creation of the trust or the establishment of the institution, if any part of its income or any property belonging to it during the relevant previous year is used or applied directly or indirectly for the benefit of any person referred to in section 13(3) [Section 13(1)(c)].
  - (e) Any income of a trust or institution, if –
    - (i) its funds are invested or deposited otherwise than in the forms or modes specified in section 11(5);
    - (ii) it holds shares in a company other than –
      - (1) a public sector company; or
      - (2) shares prescribed as a form or mode of investment under section 11(5)(xii).
- However, these restrictions do not apply in respect of :
- (i) any assets forming part of the trust as on 1-6-1973.
  - (ii) Any accretion to the corpus shares by way of bonus shares allotted to the trust.
  - (iii) debentures issued by or on behalf of any company or corporation and acquired by the trust before March 1, 1983.
  - (iv) any asset not covered under section 11(5), where such asset is held for not more than one year from the end of the previous year in which such asset is acquired.
  - (v) any funds representing the profits and gains of business, being profits and gains of any previous year relevant to the assessment year 1984-85 or any subsequent assessment year. However, such relaxation of the restriction will be denied unless the trust keeps separate accounts for the business. As already noted, subject to certain exceptions, such business profits are no longer eligible for exemption under section 11.

**(ii) Prohibited use or application** - We have noted above that when any part of the income or any property of the trust whenever created, is, during the previous year, used or applied directly, for the benefit of any person referred to in section 13(3), the denial of exemption operates. Section 13(2) specifies a few particular instances where the income or the property is to be deemed to have been used for the benefit of a person referred to in section 13(3). It should be noted that those particular instances do not in any way restrict the general meaning of the expression “used or applied for the benefit of a person”. The provisions of section 13(2) are as follows:

The income or the property of the trust or institution or any part of such income or property is to be deemed to have been used or applied for the benefit of a person referred to in section 13(3) in the following cases:

- (a) **Loan without adequate interest or adequate security** - If any part of the income or the property of the trust or institution is or continues to be lent to any person referred to in

section 13(3) for any period during the previous year without either adequate security or adequate interest or both.

- (b) **Allowing use of property without adequate rent** - If any land, building or other property of the trust or institution is or continues to be, made available, for the use of any person referred to in section 13(3) for any period during the previous year without charging adequate rent or other compensation.
- (c) **Excess payment for services** - If any amount is paid out of the resources of the trust or institution to any of the persons referred to in section 13(3) for services rendered to the trust or institution but such amount is in excess of a reasonable sum payable for such services.
- (d) **Inadequate remuneration for services rendered** - If the services of the trust or institution are made available to any person referred to section 13(3) without adequate remuneration or other compensation.
- (e) **Excess payment for purchase of property** - If any share, security or other property is purchased by or on behalf of the trust or institution from any person referred to in section 13(3) during the previous year for a consideration which is more than adequate.
- (f) **Inadequate consideration for property sold** - If any share, security or other property is sold by or on behalf of the trust or institution to any person referred to in section 13(3) during the previous year for a consideration which is less than adequate.
- (g) **Diversion of income or property exceeding ₹ 1,000** - If any income or property of the trust or institution is diverted during the previous year in favour of any person referred to in section 13(3) provided the aggregate value of such income and property diverted exceeds ₹ 1,000.
- (h) **Investment in substantial interest concerns** - If any funds of the trust or institution are, or continue to remain, invested for any period during the previous year in any concern in which any person referred to in section 13(3) has a substantial interest.

Section 13(4) provides some respite where the aggregate of the funds invested in the said concern does not exceed five per cent of the capital of that concern. In such a case, the exemption under section 11 will be denied only in relation to such income as arises out of the said investment.

(iii) **Exemption not to be denied to charitable trusts providing educational or medical facilities to specified persons [Section 13(6)]**: A charitable or religious trust running an educational institution or a medical institution or a hospital shall not be denied the benefit of exemption under section 11 merely due to the reason that the benefit of educational or medical facilities have been provided to the specified persons referred to in section 13(3). However, the value of such facilities provided to such specified persons either free of cost or at a concessional rate would be deemed to be the income of the trust. Such income would not be eligible for exemption under section 11.

(iv) **Anonymous donations [Section 13(7)]** - The exemption provisions contained in section 11 or section 12 shall not be applicable in respect of any anonymous donation referred to in



section 115BBC on which tax is payable in accordance with the provisions of that section. For example, section 11(1)(d) provides that any income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution shall not be included in the total income of such trust/institution for the relevant previous year.

However, if a trust or institution established wholly for charitable purposes receives an anonymous donation with a specific direction that the donation shall form part of the corpus of the trust or institution, such anonymous donation would not be exempt by virtue of section 11(1)(d). It would be taxable at 30% as provided in section 115BBC.

**(v) Exemption to be denied to a charitable trust having its main object as “advancement of any other object of general public utility” if its trading receipts exceed the specified threshold irrespective of withdrawal of approval or cancellation of registration or rescindment of notification [Section 13(8)]**

- (a) Under sections 11 and 12, income of any charitable trust or institution is exempt if such income is applied for charitable purposes in India and such institution is registered under section 12AA.
- (b) The definition of “charitable purpose” under section 2(15) includes “advancement of any other object of general public utility” as charitable purpose provided that it does not involve carrying on of any activity in the nature of trade, commerce or business.
- (c) However, as per the second proviso to section 2(15), “advancement of any other object of general public utility” would continue to be a “charitable purpose” in the relevant previous year even if it carries on a trading activity, if the total receipts from any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business does not exceed ₹ 25 lakhs in that year. However, if such receipts exceed ₹ 25 lakhs in the next year, then the trust will lose its charitable status for that year.
- (d) Thus, a charitable trust or institution pursuing “advancement of object of general public utility” may be a charitable trust in one year and not a charitable trust in another year depending on the aggregate value of receipts from commercial activities.
- (e) Therefore, no exemption would be available to a trust or institution for the previous year in which the receipts from commercial activities exceed ₹ 25 lakhs. However, this temporary excess in one year may not be treated as altering the very nature of the trust or institution so as to lead to cancellation of registration or withdrawal of approval or rescinding of notification issued in respect of trust or institution.
- (f) Therefore, there is need to ensure that if the purpose of a trust or institution does not remain charitable in a previous year on account of the commercial receipts exceeding the specified threshold of ₹ 25 lakhs, then, such trust or institution would not be entitled to get benefit of exemption in respect of its income for that previous year in which the commercial receipts exceed the specified threshold. The denial of exemption would be compulsory by operation of law and would not be dependent on any approval being withdrawn or registration being cancelled or a notification being rescinded.

- (g) Accordingly, section 13 has been amended to ensure that such trust and institution does not get benefit of tax exemption under section 11 or 12 in the year in which its receipts from commercial activities exceed the specified threshold of ₹ 25 lakhs, whether or not the registration or approval granted or notification issued is cancelled, withdrawn or rescinded in respect of such trust or institution.

**(vi) Prohibited category of persons** - Section 13(3) gives the list of persons, use or application of the income or property of a trust for whose direct or indirect benefit results in a denial of the exemption contemplated in section 11 for a charitable or religious trust or institution. The said persons are:

- (1) The author of the trust or the founder of the institution.
- (2) Any person who has made a substantial contribution to the trust or institution, that is, any person whose total contribution up to the end of the relevant previous year exceeds ₹ 50,000.
- (3) Where the author, founder or the person making a substantial contribution is a HUF, any member of the family.
- (4) Any trustee of the trust or manager (by whatever name called) of the institution.
- (5) Any relative of any such author, founder, person, member, trustee or manager as referred to above.
- (6) Any concern in which any of the persons referred to in clauses (1) to (5) above has a substantial interest.

**Relative** - The expression "relative", in relation to an individual, means -

- (a) spouse of the individual;
- (b) brother or sister of the individual;
- (c) brother or sister of the spouse of the individual;
- (d) any lineal ascendant or descendant of the individual;
- (e) any lineal ascendant or descendant of the spouse of the individual;
- (f) spouse of a person referred to in (b), (c), (d) or (e) above;
- (g) any lineal descendant of a brother or sister of either the individual or the spouse of the individual;

**Substantial interest in a concern** - Section 13(2)(h), section 13(3) and section 13(4) refers to cases where a person has a substantial interest in a concern. These references occur where the "Prohibited use or application" and "Prohibited category of persons" have been described. The circumstances in which a person shall be deemed to have a substantial interest in a concern, have been laid down in Explanation 3 to section 13. Accordingly, a person shall be deemed to have a substantial interest in a concern -

- (i) Where the concern is a company, if its shares, other than preference shares, carrying not less than 20 per cent of the voting power are, at any time during the previous year,

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owned beneficially by him alone or partly by him and partly by one or more of the other persons referred to in section 13(3).

- (ii) When the concern is not a company, if he is entitled or he and one or more of the other persons referred to in section 13(3) are entitled in the aggregate, at any time during the previous year, to not less than 20 per cent of the profits of such concern.

**(5) Anonymous Donations received by Charitable Trusts/Institutions to be subject to tax [Section 115BBC]**

- (i) As per the provisions of the Income-tax Act, 1961, tax exemption under section 10(23C) and section 11 are available to certain entities, as briefed in the table below, on fulfillment of the conditions prescribed under the relevant sections –

Entity	Applicable section
Charitable or religious trusts/institutions	11
Universities and other educational institutions	10(23C)(iiiad) and (vi)
Hospitals and other medical institutions	10(23C) (iii ae) and (via)
Notified funds or institutions established for charitable purposes	10(23C)(iv)
Notified trusts or institutions established wholly for public religious purposes or wholly for public religious and charitable purposes	10(23C)(v)

- (ii) Section 115BBC has been inserted to tax anonymous donations received by the above entities at 30%.

(iii) In order to provide relief to these trusts and institutions and to reduce their compliance burden, an exemption limit has been introduced, and only the anonymous donations in excess of this limit would be subject to tax@30% under section 115BBC.

- (iv) The exemption limit is the higher of the following –

- (1) 5% of the total donations received by the assessee; or  
(2) ₹ 1 lakh.

- (v) The total tax payable by such institutions would be –

- (1) tax@30% on anonymous donations exceeding the exemption limit as calculated above; and  
(2) *tax on the balance income i.e. total income as reduced by the anonymous donations which have been subject to tax@30% under section 115BBC.*

- (v) The following table illustrates the calculation of anonymous donations liable to tax @30% under section 115BBC –

Situation	Total donations during the year (₹)	Anonymous donations received during the year (₹)	Exemption (₹)	Anonymous donations taxable@30% (₹)	Donations subject to tax at normal rates (₹)
1	15,00,000	4,00,000	1,00,000	3,00,000	12,00,000
2	30,00,000	7,00,000	1,50,000	5,50,000	24,50,000
3	40,00,000	10,00,000	2,00,000	8,00,000	32,00,000

(vi) For this purpose, "anonymous donation" means any voluntary contribution referred to in section 2(24)(ia), where the person receiving such contribution does not maintain a record of the identity indicating the name and address of the person making such contribution and such other particulars as may be prescribed.

(vii) However, the above provision does not apply to a trust or institution created or established wholly for religious purposes.

(viii) Further, anonymous donations to trusts/institutions created or established wholly for religious and charitable purposes (i.e. partly charitable and partly religious institutions/trusts) would be taxed only if such anonymous donation is made with a specific direction that such donation is for any university or other educational institution or any hospital or other medical institution run by such trust or institution. Other anonymous donations received by such trusts/institutions are not taxable.

(ix) Section 13(7) provides that the exemption provisions contained in section 11 or section 12 shall not be applicable in respect of any anonymous donation referred to in section 115BBC on which tax is payable in accordance with the provisions of that section.

(x) For example, section 11(1)(d) of the Act provides that any income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution shall not be included in the total income of such trust/institution for the relevant previous year. However, if a trust or institution established wholly for charitable purposes receives an anonymous donation with a specific direction that the donation shall form part of the corpus of the trust or institution, such anonymous donation would not be exempt by virtue of section 11(1)(d). It would be taxable at 30% as provided in section 115BBC.

(xi) Similarly, section 10(23C) provides that any anonymous donation referred to in section 115BBC on which tax is payable in accordance with the provisions of the said section shall be included in the total income. Consequently, sections 10(23C) and 13 provide that any income by way of any anonymous donation which is taxable under the provisions of section 115BBC shall not be excluded from the total income of the trust or institution.

**Illustration 22**

Income from property held under trust is ₹ 6 lakh. The voluntary contributions received by a trust is ₹ 20 lakh, which includes anonymous donations of ₹ 4 lakh and corpus donations of ₹ 5 lakh. The trust has applied ₹ 10 lakh to purchase a building on 1.8.2014 for meeting its objective. Compute the tax liability of the trust for A.Y.2015-16.

**Answer**

Particulars	₹	₹
Income from property held under trust <sup>4</sup>		6,00,000
Voluntary contributions	20,00,000	
Less: Corpus donations (not taxable)	5,00,000	
	15,00,000	
Less: Anonymous donations (taxable@30% under section 115BBC) [₹ 4,00,000 – ₹ 1,00,000]	3,00,000	
		12,00,000
		18,00,000
Less: 15% of income eligible for retention/ accumulation without conditions <sup>5</sup>		2,70,000
		15,30,000
Less: Purchase of building for the purpose of the trust		10,00,000
Total Income (excluding anonymous donations taxable@30%)		5,30,000

The tax payable by the trust would be the aggregate of –

- (i) ₹ 90,000, being income-tax calculated@30% on ₹ 3 lakh (i.e., ₹ 4 lakh – ₹ 1 lakh); and
- (ii) ₹ 31,000, being income-tax calculated at normal rates on ₹ 5.30 lakh (i.e., ₹ 5,30,000).

The total tax payable would be ₹ 1,24,630 (₹ 1,21,000 plus cess@3%)

**4. Tax Exemption to Political Parties [Section 13A]**

Section 13A of the Income-tax Act, 1961 grants exemption from tax to political parties in respect of their income specified below:

<sup>4</sup> Depreciation on building is not allowable since cost of acquisition of building has been claimed as application of income. It is assumed that depreciation on building has not been charged while computing income from property held under trust.

<sup>5</sup> A view is taken that 15% of ₹ 1 lakh, representing the amount of anonymous donations exempt from applicability of 30% tax, is also eligible for retention/accumulation without conditions in line with other voluntary contributions. A contrary view may also be possible due to the language used in section 13(7), that such anonymous donations chargeable to tax at normal rates are not eligible for retention/accumulation. If this view is taken, ₹ 2,55,000, being 15% of ₹ 17,00,000 has to be set apart (instead of ₹ 2,70,000, being 15% of ₹ 18,00,000).

- (i) Income from house property;
- (ii) Income from other sources;
- (iii) Capital gains; and
- (iv) Income by way of voluntary contributions received by the political parties from any person.

The aforesaid categories of income would qualify for exemption without any monetary or other limit and the income so exempted would not even be includible in the total income of the political party for the purpose of assessment. The tax exemption will be applicable only if the following conditions are fulfilled:

- (i) The political party must keep and maintain such books and other documents as would enable the Assessing Officer to properly deduce the income of the political party from those accounts.
- (ii) The political party must keep and maintain records in respect of each such voluntary contribution which is in excess of ₹ 20,000 giving details of the amount received, the name and address of the person who has made the contribution, the date of receipt and such other details as may be relevant or appropriate. However, this does not mean that the political party need not disclose smaller contributions in its accounts which are maintained by it. The obligation to maintain proper record of voluntary contribution in excess of ₹ 20,000 is over and above the obligation to maintain proper records and books of accounts in respect of all the income and expenses of the party.
- (iii) The accounts of the political party must be audited by a Chartered Accountant.
- (iv) A report under section 29C(3) of the Representation of People Act, 1951 has to be submitted by the treasurer of such political party or any other person authorised by the political party in this behalf for every financial year. If there is a failure to submit the above report, no exemption under this section shall be available for the political party for that financial year.

For the purposes of this section, "political party" means a political party registered under section 29A of the Representation of the People Act, 1951.

## **5. Exemption for Voluntary Contributions Received by Electoral Trusts [Section 13B]**

- (i) Any voluntary contribution received by an electoral trust (as may be approved by the CBDT in accordance with the scheme to be made by the Central Government) shall be treated as its income under section 2(24), but shall be exempt under section 13B, if the trust distributes to a registered political party during the year, 95% of the aggregate donations received by it during the year along with the surplus if any, brought forward from any earlier previous year.
- (ii) Another condition for availing the benefit under this section is that the electoral trust should function in accordance with the rules made by the Central Government.